STATE OF CALIFORNIA

DEPARTMENT OF INSURANCE

300 Capitol Mall, 17th Floor

Sacramento, California 95814

January 1, 2013

Workers' Compensation Claims Cost Benchmark

and Pure Premium Rates

File No. REG-2012-00016

Friday, November 16, 2012

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TRANSCRIPT OF PROCEEDINGS, taken at Employment Development Department, noticed on behalf of the State of California, Department of Insurance, Government Law Bureau, 722 Capitol Mall, Auditorium, First Floor, Sacramento, California, commencing at 9:37 a.m., Friday, November 16, 2012, before Staci A. Iwahashi, CSR No. 11807.

A P P E A R A N C E S

DEPARMENT OF INSURANCE PANEL:

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RONALD A. DAHLQUIST, Chief Actuary

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MARK SEKTNAN, Vice President, State Government Relations and President, ACIC, Property Casualty Insurers Association of America

RICHARD MARKUSON, Pacific Advocacy Group

P R O C E E D I N G S

MR. CITKO: Good morning, I'm Christopher Citko, senior staff counsel with the Department of Insurance, and I'm going to open our hearing today.

This hearing is regarding the proposed revisions to the Insurance Commissioner's regulations pertaining to classification of risks, recording and reporting of data, and experience rating for workers' compensation insurance in the approval of advisory pure premium rates in the workers' compensation claims cost benchmark. This is to be effective January 1st, 2013, and our file number is REG-2012-00016.

We received a filing from the Workers' Compensation Insurance Rating Bureau, an insurer rating organization, regarding the rule changes on pure premium rate adjustment. That was amended on October 1st, 2012, and addressed the substantial legislative reforms that were in SB 863. We did provide notice of this proceeding through notice of proposed action and public hearing. It was issued August 28th, 2012, along with initial statement of reasons for a hearing to be held on September 24th, 2012.

Subsequently and as a result of the legislation that needed to be analyzed, the hearing was canceled and the matter continued for the amended filing from the Rating Bureau. An amended proposed action and notice of public hearing was issued on November 7th, 2012 with an amended initial statement of reasons for today's hearing. This matter is being held pursuant to insurance code sections 11734, 11750 and 11750.3.

The record in this matter is going to be closed today, November 16th, 2012, at 5 o'clock p.m. In addition to the testimony being presented today, additional written comments and evidence may be provided up until the time that the record is closed unless further time is granted at the end of these -- before the end of these proceedings.

Testimony today will be recorded by the reporter who is to my right and there will be a transcription of the testimony available. Copies of the transcript, if anyone would like to obtain it, should be requested from the reporter and the reporter has cards to provide at the end of the hearing if you would like that. Then, in addition, we'll provide contact information later on if anybody needs that.

I would like to admonition everyone that does come forward to testify today to please identify yourself with your full name, and if you do represent somebody, who you represent. If you come forward and testify, please also speak loudly and clearly so the reporter can take down what you say. Also, please respond -- if we ask questions, respond to them verbally. Nodding your head, shaking your head, going "uh-huh," "huh-uh" doesn't come out on the record very well and we'll remind you so that we can get a clear record of the proceedings today.

Also, please do not speak too quickly. I've told the reporter that if someone does speak too quickly she can tell you to slow down and I'm sure she will let you know. With that, I wanted to let you know that the order of presentation today is that we'll first hear from the Rating Bureau regarding its filing. We will then hear from the public members of the governing committee of the Rating Bureau and their actuary, and then finally, we'll take in any public comment or testimony that anyone would like to give.

If you are going to provide to us documentation, I'll receive that and we'll make sure that we note that in the record today. And I'll try to summarize all the documents at the end of the proceeding.

The panel here today includes myself, Ron Dahlquist our chief actuary, and Insurance Commissioner Dave Jones. And with that, Commissioner Jones, if you would like to make an opening statement.

COMMISSIONER JONES: Thanks.

Welcome everyone. I want to apologize first and foremost about the venue. I feel a little odd being up here on stage, and so, I hope you bear with us. But we're most appreciative that you've taken the time to attend and we're very eager to hear your testimony as the proceeding moves forward.

As was explained a moment ago, the purpose of the hearing is to evaluate the cost in California's worker' compensation insurance system as laid out in the pure premium rate filing and analysis from the California Workers' Insurance Rating Bureau or WCIRB, and we'll have a chance to hear directly from them in a moment.

I think it is important, though, particularly for those members of the public who are not as familiar with this process to underscore what exactly we mean by the term "pure premium." Pure premium is often misunderstood by the general public and employers who are required to have workers' compensation insurance. Pure premium is the portion of the premium needed to cover the insured's claims costs and claims handling expenses. Workers' compensation insurers are free to set their rates wherever they chose with one exception, those rates have to be sufficient to make sure the companies remain solvent.

And it wasn't too long ago that over 30 workers' compensation companies in California became insolvent, the terrible consequences for employers purchasing workers' compensation insurance. Prices shot up, insurers that were not insolvent exited the market, the Department of Insurance had to take over many insurers; employers had a hard time finding or affording workers' compensation insurance.

Again, it's important to underscore the Insurance Commissioner nor the Department of Insurance do not set workers' compensation rates. Anyone who tells you that the Insurance Commissioner sets the rates is simply not telling you the truth, and it's particularly disingenuous for publications, publishers or reporters who report expertise in workers' compensation to tell readers that the Commissioner or the Department sets rates. These so-called experts know better.

The law does direct the Insurance Commissioner to issue an advisory pure premium benchmark rate and rates after receiving a recommendation from the Workers' Compensation Insurance Rating Bureau. This is important so that insurance carriers, and the market, and employers, and brokers, and agents have good information about costs in the system and to assist carriers in setting rates so as to avoid insolvency. While no one likes increased rates, there is something far worse, insolvency of insurers, shortage of insurance and then prices rocket even higher as occurred only a short time ago in California with disastrous consequences for our economy.

Indeed past commissioners have been hesitant to issue the advisory pure premium benchmarks because of the misreporting that commissioners actually set the rates themselves. But again, the pure premium advisory rates and benchmark are exactly that. Advisory. Insurers are free to set rates under our laws as they see fit.

Now, earlier this year the legislature and the governor enacted an important package of workers' compensation reforms through Senate Bill 863. These reforms had two major components; increasing needed benefits to permanently injured workers and cost savings. I applaud the hard work of stakeholders which included labor and employers in fashioning these reforms. And applaud the legislature in passing SB 863 and the governor and his staff in supporting the legislation.

With the passage SB 863 we need to measure as a part of this proceeding any costs and savings for the entire workers' compensation system associated with the SB 863 reforms as well as measure and evaluate underlying cost pressures that are occurring in the system concomitantly.

The first major component of SB 863 provides for an increase in permanent disability benefits to injured workers, benefits that previously were inadequate. Utilizing objective criteria to determine impairment in providing limits on what can be compensated, the permanent disability reforms also help to address areas of potential abuse.

The second major component of SB 863 provides for system reform particularly associated with the delivery of and payment for medical treatment resulting in projected cost savings to cover the permanent disability increases and bring additional savings and stability to the system.

These reforms include independent review of medical treatment requests and billing disputes. Additionally, problems that we've seen with the filing of medical liens are also addressed providing for more potential savings.

The workers' compensation system has struggled to stabilize rising costs over the last few years. Particularly, medical costs. The tools that employers and insurers used to control medical costs have not been as effective as we might wish or were underutilized in some cases. There have been double digit annual increases in medical costs. The SB 863 reform has put in place an opportunity for additional decreases of medical cost inflation and further system stability. And in turn, will assist with making the costs in the system more predictable.

After reviewing the SB 863 reforms and trends in the workers' compensation system, the WCIRB actuarial committee recommended a pure premium benchmark of $2.61 per $100 of payroll.

The WCIRB governing committee instead is recommending a pure premium benchmark of $2.38 per $100 of payroll.

The purpose of today's hearing is to take testimony and evidence with regard to the WCIRB's recommended pure premium benchmarks and rate filing. Based on the testimony and evidence from this hearing, I'll then issue a pure premium advisory benchmark.

So with that, why don't we hear from our first witnesses, the representatives from the Workers' Compensation Insurance Rating Bureau. We want to welcome them to the hearing and are most appreciative of their spending time with us this morning and setting forth information for us with regard to the rate filing.

Welcome.

MR. MUDGE: Thank you.

Good morning, Commissioner Jones, Mr. Citko, Mr. Dahlquist, I'm Bill Mudge. With me is Dave Bellusci from the WCIRB.

This morning we'll provide a brief summary and perspective of the advisory pure premium rate filing we recently submitted for your review. We too recognize that pure premium rates issued or approved by the Insurance Commissioner are advisory only and that insurers are not required to use them. I will make a few opening comments and observations and then ask Dave to expand upon our actuarial analysis of the underlying cost drivers that have been contributing to the ongoing upward escalation in claims costs. And we'll provide perspective on our evaluation of the costs and savings that we have quantified to date from Senate Bill 863.

We will provide this morning some context for our proposed January 1, 2013 pure premium rates, including our current actuarial evaluation of the impacts of SB 863. We will touch on SB 863 provisions that remain to be evaluated pending promulgation of regulations by the DWC.

We'll also share risks we see in terms of potential new consequences from SB 863's structural reforms. And equally or maybe more importantly, our action plan to closely monitor the cost effects and trends of the legislation and regulations and to report our empirical observations as quickly as practical to you.

There's no question that since the reforms of 2002 through 2004 were fully implemented by 2005, that since that time ultimate claims costs adjusted for the effects of frequency in the California workers' compensation insurance system have been steadily going up.

If we look at this slide that I'm now showing which we shared at our mid-year rate hearing, we see the context for our concern with this ongoing upward trend in the indemnity cost index as depicted by the green line on the top there. This claims cost level indexed starting at 2005 shows a markedly higher trend than the index of average wage level growth or the underlying exposure base in the system as shown on the tan line.

Said another way, workers' compensation claims and resulting costs have outpaced the California economy and have been putting upward pressure on an indicated pure premiums. And no doubt, this disparity in claims costs to exposures was a driving force for the systemic change that we now have in SB 863.

Looking at this slide a bit further we show the top line there -- the top dotted orange line reflects our actuarial projection of costs for 2013 using data as of June 30, 2012, but with no SB 863 impact. If you will, that top orange dotted line is the world pre-863 as if the system continued the way it has.

The blue dotted line in the center shows how that cost line flattens based on our actuarial estimate of the areas we believe are currently quantifiable within SB 863.

The bottom line, the red dotted line, depicts a downward trajectory in costs based on a greater reflection of savings from SB 863 aligned with our amended filing and is in recognition of the unusually high level of uncertainty surrounding yet-to-be-developed regulations and the potential for additional savings from SB 863 beyond that which is currently quantifiable.

Dave will provide a more detailed perspective on SB 863 in just a moment. But if we bring, then, though the compositive costs together with payroll in terms of an advisory industry pure premium benchmark, this slide provides a relevant range of those perspectives.

Starting on the far left, $2.38, that's the insurance industry's average filed pure premium rate as of July 1, 2012. Moving to the right next to that, $2.68, is our indicated average January 1, 2013 pure premium rate from our original August 21 filing based on at that time March 31, 2012 industry loss and loss adjustment expense experience and using methodologies that were similar to the filing we made for July 1, 2012.

Moving across at $2.73 is an update to our August 21 filing simply using now June 30th, 2012 industry experience which reflects about a two percent deterioration from the March 2012 data.

The next at $2.86 now adds in just the permanent disability benefit increases that were spelled out in SB 863. So this indication at $2.86 is a reflection of now our best experience through June of the industry and just the benefit increases from SB 863, an indication as if no reform savings were to occur.

Now, $2.61 reflects now the savings from the areas that we the WCIRB have actuarially quantified at this time. Areas of SB 863 that are dependent upon regulations yet to be promulgated and speculating on the potential impact on costs and utilization of medical treatment from the new independent medical review process within SB 863 are not included in that number.

$2.38 on the red bar there reflects the amended filing we submitted to the Department of Insurance on October 1 based on no increase in the advisory pure premium rate level for January 1, 2013. That was in recognition of the uncertainties around the potential for additional cost savings from SB 863, components that have yet to be quantified by our organization.

Now clearly, several of SB 863's provisions do aim directly at many of the key factors that have given rise to the upward trend in lost costs since the last major reforms of 2002 through 2004. The magnitude of those potential savings has been and is the focus of much actuarial debate and professional dialogue.

Finally, the last bar shown on the chart we've appended from a preliminary estimate from the Department of Insurance of average filed pure premium rates from a number of companies that have submitted filings now for January 1, 2013. And that number in aggregate is $2.49, up about 5 percent from the July 1, 2012 benchmark.

I'm going to turn the rest of our presentation over to Dave Bellusci. He'll provide a more in-depth analysis of our SB 863 evaluation, and equally important as I said, our plans for ongoing monitoring of its effects on industry lost costs.

Dave?

COMMISSIONER JONES: Bill, before we do that, I'm just wondering -- just to help the thing flow, I have a series of questions that I wanted to posed to you and then maybe we could go to Dave's testimony if that's all right?

MR. MUDGE: Sure. Dave and I might answer those --

COMMISSIONER JONES: I understand.

MR. MUDGE: -- together.

COMMISSIONER JONES: Absolutely. Absolutely.

So what strikes me is the dramatic difference between what the WCIRB actuarial committee recommended as the actuarially indicated pure premium rate considering all of the consequences of SB 863 and what the governing committee adopted and sent forward with the rate filing.

So I'm wondering if you could explain for us in general the process that the governing committee uses to make its decision about the pure premium rate benchmark and pure premium rates generally.

MR. MUDGE: Right. I will say that the governing committee meeting -- some of our committee members are here present today -- was not without significant discussion and debate on this issue of, What are the magnitude of potential savings from SB 863 --

COMMISSIONER JONES: But let me clarify. I'm interested in how it's done generally and then I want to -- I do want to drill down --

MR. MUDGE: Right. So I --

COMMISSIONER JONES: -- in a moment to what specifically happened at that governing committee.

MR. MUDGE: Right.

COMMISSIONER JONES: But just generally if you can provide an overview of how it's done, that would be helpful.

MR. MUDGE: Sure. So in open session, staff, Dave, our actuaries, myself, we present the work that has come forth from the actuarial committee to all of the members of the governing committee. They get a detailed amount of information in advance of our meetings, and there is a unlimited amount of time available for committee members to question staff, to dialogue on materials that they have received and to make sure that there is a understanding from their perspective on what staff is recommending to the committee for its consideration.

COMMISSIONER JONES: And what did the WCIRB actuarial committee recommend to the governing committee with regard to this particular amended rate filing?

MR. MUDGE: Right.

Dave, do you want to cover that question in as much detail as the Commissioner would like?

MR. BELLUSCI: Sure.

MR. MUDGE: And then I'll jump back in.

MR. BELLUSCI: Sure.

Good morning, Commissioner. Yes, the process -- let me describe a little bit because this was an unusual process given SB 863 and the enactment.

The actuarial committee went through a fairly detailed process. There were two meetings held in September that were public meetings from the entire actuarial committee as well as a number of people from our claims working group, which consists of insurers, claims personnel, legal personnel, researchers, and plus a broad range of other experts in the workers' comp system; representatives from the Division of Workers' Comp, your own staff from the California Workers' Comp Institute, the Commission on Health & Safety, UC Berkeley, and others, so a very broad group.

And that group, you know, looked at the

provisions of SB 863 very closely and in many instances -- as I'll talk about a little later -- there was, you know, informed judgments made and those were reflected in an analysis that was presented to the governing committee at their meeting and summarized as Mr. Mudge mentioned in a fair amount of detail.

The indication based on the actuarial committee's evaluation of SB 863 was a net savings of about 4.4 percent when combined -- of the bill 4.4 percent from SB 863. When combined with the latest June experience, that would produce the indication shown up there at $2.61. The combination of the most current loss experience reflected in the deteriorating trends that Mr. Mudge alluded to earlier as well as the actuarial committee's consensus, uh, reflection of the impact of SB 863.

COMMISSIONER JONES: And just since we're on this point, so over what period of time was that analysis prepared?

MR. BELLUSCI: Well, the analysis really started even before the legislation was passed. Once we were requested by yourself as well as Director Baker of the Department of Industrial Relations to try to assess some of the proposals that ultimately turned into SB 863 in the latter part of August, staff worked with it and consulted with a number of these individual -- on an individual basis, we didn't have an opportunity to bring the actuarial committee together but we consulted with a number of experts individually throughout that process all through the last couple weeks of August.

Then we had an initial meeting on September 5th shortly after the bill was passed on August 31st that included the actuarial committee and the claims working group that I alluded to earlier. At Mr. Citko's request, we came back. There were some open issues that we needed a little more discussion, pull a little more data together, so we came back and met I believe it was September 16th. I could be wrong on that date. But we met again in September and then ultimately built the analysis -- based on that process, built the analysis that was presented to the governing committee on I believe it was September 26th.

COMMISSIONER JONES: So about a month and a half, maybe two months of analysis?

MR. BELLUSCI: That's correct. I guess from the early staff analysis from the middle of -- the middle of August until it went to the governing committee at the end of September. And even beyond that, as you may recall, we made one slight amendment to it based on some new information that we gathered that was submitted on October 12th. So it is a -- in many ways it is an ongoing process. As regulations get adopted, estimates are going to be evaluated. So it's a -- we don't feel we're anywhere close to done. And we won't know with good certainty for a couple years what those real costs are.

COMMISSIONER JONES: So about three months of analysis then all told to bring us to where we are?

MR. BELLUSCI: Yes.

COMMISSIONER JONES: And then, you alluded to some of the individuals and groups that were involved in doing that analysis. But can you be a little more specific about the individuals and groups that were not involved in that sort of three-month analytical process?

MR. BELLUSCI: A little more sense about the groups that were involved?

COMMISSIONER JONES: Yeah, or the individuals or -- who does this analysis, I guess, is the better way to ask the question?

MR. BELLUSCI: Well, there are a number of organizations that were doing components of analysis independently. You know, CWCI published some information. Mark Priven from Bickmore Risk

Association for the Department published a number of analyses. The Commission on Health & Safety and Workers' Comp have done some things in the past. State Fund I think published some estimates. So there was a wide range of groups that were doing work on this.

We reviewed all of that and consulted with all those parties involved. In our -- and we brought all those parties together around the table. As I mentioned, you know, Lachlan Taylor was involved from the Commission on Health & Safety and Workers' Comp. Alex Swedlow and Michael Nolan from CWCI. Mark Priven from Bickmore Risk Associations, representatives of the Division of Workers' Comp, some of your own staff were involved in some of those meetings, as well as WCIRB staff who was leading the process, as well as a number of insurer representatives who are on our committees or working groups, some of which come from a claims perspective, some of which come from a legal perspective. So it was a very broad group of experts -- you know, very diverse in research, in actuarial, claims, legal. It was, again, a very broad group of experts.

COMMISSIONER JONES: And then --

MR. CITKO: I just want to say "CWCI" means California Workers' Compensation Institute.

MR. BELLUSCI: Oh, okay. Thank you.
MR. CITKO: I just want to make --
COMMISSIONER JONES: Just for the reporter's help.
MR. BELLUSCI: Thank you.
COMMISSIONER JONES: And then, in the course of that analysis in that discussion/deliberation -- that broad analysis on discussion/deliberation that you described, was there discussion on the part of the actuarial committee with regard to the merits or demerits of available data sources in reaching the conclusion the committee -- the committee reached?
MR. BELLUSCI: Yes. Very, very much so. And each -- you know, each provision of SB 863 -- each of the key provisions -- there were many diverse provisions as you're aware -- sort of had its own issued around it. Sometimes there were very good data and very direct data that the computation was relatively straight forward and in other issues -- in other areas there were, uh -- there was a consensus that, you know, a particular provision will save costs.
And I'll give one example: The impact of independent medical review on temporary disability duration. Temporary disability duration has been growing in California. It's well above other states now

and it's been growing -- steadily deteriorating. I think there was agreement that part of the reason for that -- for that deterioration over the last five years was delays related to medical treatment disputes.

Well, independent medical review, if it works as we all hope, should reduce those delays, should result in quicker decisions on medical treatment disputes; that's going to have an impact on temporary disability duration. Exactly what that impact is, is a matter of judgement.

So as a group there was discussion -- there was no way to directly measure that, but as a group, uh, there was a consensus about a reasonable, you know, assumption on what that impact on temporary disability duration would. That's one of the extremes where there was a consensus in terms of savings would be materialized but very difficult to come up with a precise estimate.

In other areas, for example, benefit increases, those are fairly straight forward. They're very real. They don't depend on implementation regulations for the most part. It's a fairly straight forward traditional actuarial process to measure those. So there was less -- I guess, less discussion and less confusion.

So it's a wide range of things where the data is very solid and very, you know, traditional, standard actuarial methods to value the impact of those and then other areas where there was limited data and even no direct way to do that. But ultimately when there was a consensus of the group that there would be some savings, the group built a consensus around a reasonable estimate.

COMMISSIONER JONES: So it sounds like in the course of reaching the actuarial committee's recommendation which was essentially $2.60 per $100 of payroll which was just recently modified to $2.61, that the committee and the experts and the staff weighed alternative estimates and evaluated them and decided which ones they thought were reasonable and which ones not so reasonable in reaching their conclusion?

MR. BELLUSCI: Yeah, that's a fair assessment, Commissioner.

COMMISSIONER JONES: Okay. And then I guess with regard to estimates of cost and cost savings, I mean, I take it that the committee operates by consensus?

MR. BELLUSCI: Typically by consensus. Though, ultimately the actuarial committee there are issues when there's a different of opinion. We will take a vote. And so it's a combination of consensus where there's a relative unanimity among the group. But if there's a strong differentiation of opinion, we'll take a vote and move in terms of majority. And at least in one instance and maybe two, you know, there was some differences of opinion and there were a split vote at least in one instance in that discussion that I recall.

COMMISSIONER JONES: And just out of curiosity, what was the order of magnitude of differences in cost savings associated with those two items for which there was a split vote?

MR. BELLUSCI: Well, the one I recall -- and I could clarify better -- was a difference in terms of the impact of changes in claim benefits on the impact on claim frequency. It's kind of known as the utilization factor. There was agreement that there is -- a utilization factor is appropriate. Some disagreement on the magnitude. But, uh, my recollection, you know, it was -- the differences of the impact were very modest, you know, maybe less than a percent on total cost. So it wasn't -- while there was a difference of opinion and ultimately a split vote on it, the bottom line result of the two differences were, you know, relatively modest.

COMMISSIONER JONES: So just to be clear, the split vote was just on those two relatively modest items.

With regard to the final actuarial committee recommendation of $2.60, was there a split vote with regard to that recommendation?

MR. BELLUSCI: Well, just to clarify how the committee operates a bit, the committee doesn't make a decision about what the final rate indication is. They make a decision about methodology. So they -- each component of the bill we came to a consensus or a vote on what would be the saving estimate. We didn't put the numbers together and they didn't adopt $2.61. They looked at each of the components and then staff put all those assumptions together.

But I would say, I think to the substance of your question, there -- area -- there wasn't -- areas where there was disagreement on the committee, uh, were relatively narrow and didn't have -- wouldn't have major impact on the $2.60 and later adjusted to $2.61 indication.

COMMISSIONER JONES: Okay. And then let me, if I could, ask Mr. Mudge to come back because I just wanted to continue some questions I had about the process then of the governing committee as distinct from the actuarial committee.

So it's my understanding that the actuarial committee then did recommend a pure premium benchmark of $2.60 to the governing committee and I take it that the -- as you explained, Mr. Mudge, the governing committee had that recommendation in front of it when it took its action ultimately adopting a recommended pure premium benchmark of $2.38. So it had the actuarial committee's recommendation in front of it at that time?

MR. MUDGE: Well, again, just to clarify on what the actuarial committee recommended is, Mr. Bellusci said the actuarial committee recommended and had consensus and discussion about methodology and impact of components of SB 863, and then staff actually worked the calculations that then resulted in the output being $2.60. So the actuarial committee did not recommend a claims cost benchmark number. They directed staff to use what they came to agreement about in terms of process and elements. And then staff worked it into that -- into that advisory pure premium rate calculation. But all of that information, actuarial committee work, background and such, and then all of staff's work around that certainly is all available and was all available to the governing committee members.

COMMISSIONER JONES: And I would imagine the benefit of doing it that way from a process standpoint is it, at some level if you will, depoliticizes the concern about what that ultimate rate might be if the committee is reaching conclusions about the component parts and then without having to be too concerned about what the ultimate outcome is, and then the staff essentially does the math, and then presents that result to the governing committee; is that correct?

MR. MUDGE: That's a fair summary.

COMMISSIONER JONES: Okay. And then -- so I'm still struck by the dramatic difference between what the actuarial indicated pure premium benchmark rate would be of $2.60 or that was just recently adjusted to $2.61 versus the governing committee's pure premium benchmark decision of $2.38.

So I'm wondering if you could share with us what the rationale was that the governing committee had for so dramatically departing from what the actuarially indicated rate was?

MR. MUDGE: Well, as you know, those are open meetings. The governing committee meeting was an opening meeting. I think the process and result of that specific committee meeting was chronicled by the media, and as you know and as I'll summarize for you, it was anything but a clear bright line in terms of what that outcome would be from the committee. In fact, it was as close a vote as you could have.

COMMISSIONER JONES: Of the governing committee?

MR. MUDGE: Of the governing committee.

COMMISSIONER JONES: Yes.

MR. MUDGE: Yes.

COMMISSIONER JONES: It was a split vote?

MR. MUDGE: It was a very split vote.

COMMISSIONER JONES: Yes.

MR. MUDGE: With six, four and five against the motion that was on the table which ultimately then did pass in vote to make no change to the advisory pure premium benchmark.

There was a lot of debate in that meeting and a lot of discussion. But ultimately, when a vote was called for on the motion on the table by the chairman, that's how the vote came down.

COMMISSIONER JONES: So then, just to be clear because you're right, there was a split vote. With regard to the majority that supported the motion, what was the rationale for so significantly departing from the actuarially indicated pure premium benchmark?

MR. MUDGE: Yeah. I think you could ask some of them who are here today possibly. But I would say that my take on the dialogue and discussion that led up to that was a function of (1) understanding the actuarial work that was done by the actuarial committee and then subsequently staff and respecting that work, but also with a belief in, I think, a lot of maybe historical expertise and experience vis-a-vis the system when there is major reform that there's a great degree of uncertainty around what ultimately the savings from the system will be.

And I think there was certainly on the table and well discussed that recent reforms -- the last set of reforms from 2002 through 2004, that ultimately when hindsighted on how those reforms worked out, by far and away the savings exceeded anyone's estimates that were made, even the ranges of estimates that were made at the time. And so I think there was some sense among some of the committee members that this set of structural reforms could equally have -- maybe not to the same degree, but could equally have savings that would surpass what the best estimates were at the moment in time. I think that was probably in among their thinking.

I think the other element that was among their thinking was the fact that we at staff and also the actuarial committee felt that there are areas for potential savings within 863 that we just can't value at this point in time. We're pending regulations to be adopted. And I think there was significant discussion about what exactly independent medical review would do; not to the dispute resolution and administration of benefits but what will it do to changing medical treatment and medical utilization patterns within the system.

Medical as you know is such a significant part of the totality of costs in comp that even a very minor or modest movement in a positive direction relative to medical trend can have a significant impact ultimately in what a claims cost benchmark number would be.

So I think to sum up without actually being in their heads and such, that I think they were reflecting on the significant benefits that came from the last set of reforms that far surpassed the actuarial thinking at the time. And secondly, that their belief -- and many of them I think were actively involved in the legislation itself, a belief that the areas that we could not evaluate at this time would have significant additional savings. And given that and the uncertainty around the potential benefits, there was a -- I think a sense in ultimately a decision among the majority that this would not be the time to go forth with a rate increase or advisory pure premium rate increase to the system.

COMMISSIONER JONES: The cost savings delta associated with the actuarially indicated pure premium rate coming out of the actuarial committee's work versus the governing committee's majority split vote recommended pure premium rate, what's the actual cost savings necessarily implicated by those two different figures? In other words, to get to the governing committee's recommended pure premium rate, how much additional money would have to be saved in the system in order to achieve that pure premium rate?

MR. MUDGE: Right. No, it's a great question, Commissioner. We've actually looked at that.

COMMISSIONER JONES: Okay.

MR. MUDGE: I'll ask Dave to step back up here and give you the specifics. We've looked at it a couple of different ways.

COMMISSIONER JONES: Okay.

MR. BELLUSCI: Yeah it is a -- it is good --

COMMISSIONER JONES: I just need the number.

MR. BELLUSCI: Pardon me?

COMMISSIONER JONES: I just need the number.

MR. BELLUSCI: Yeah. The number, it's about three to one roughly. So I mentioned that the savings we estimated were about 4.4 percent --

COMMISSIONER JONES: Can you --

MR. BELLUSCI: -- from the actuarial committee.

COMMISSIONER JONES: Can you give it to me in absolute numbers?

MR. BELLUSCI: In dollars?

COMMISSIONER JONES: Yes, sir.

MR. BELLUSCI: Yeah, in dollars, uh -- remember my dollars, so I had to try to go clarify it. The savings from the reforms were about 1.7 billion that we quantified. That would have to ... Double roughly? Tony?

MR. MILANO: Yes.

MR. BELLUSCI: It would have to more than double to produce the savings so we would be talking about another $2 billion roughly in terms of savings.

COMMISSIONER JONES: Okay. So just to be clear: So the savings identified by the actuarial committee's extensive three-month evaluation were about 1.7 billion --

MR. BELLUSCI: Roughly it was about 1.6, 1.7. Those were the savings of the reform. Not the net because there were benefit increases.

COMMISSIONER JONES: I understand.

MR. BELLUSCI: Right.

COMMISSIONER JONES: But the additional savings on top of that $1.7 billion in savings as such with SB 863, the additional savings that would have to be assumed in order to reach the governing committee's adopted pure premium benchmark rate of $2.38 is roughly another -- another $2 billion?

MR. BELLUSCI: That's correct.

COMMISSIONER JONES: Okay. So then if I could go back to Mr. Mudge then.

So with regard to the two bases for the governing committee's -- governing committee majority's decision, you said one of those was what happened last time with the reforms. Has there been any quantification with regard to the difference in savings that were projected by actuaries with regard to the 2002-2004 reforms and the savings that actually resulted from those reforms? And what's the -- what's the absolute dollar figure on those savings?

MR. MUDGE: I'll have Dave answer that question as well. But I can tell you that another way of looking at this issue of what level of savings has to occur for the $2.38 benchmark to hold would be about a 40 percent reduction in the increase in cost we've seen since the reforms were fully implemented on that chart I showed from 2005 to today. If we're able to with the reforms of SB 863 tilt that down and reduce 40 percent of that increase over this period of time, then that's another way of showing that that $2.38 number could hold. And I believe we put that in the materials that we provided to you. But I'll let Dave answer --

COMMISSIONER JONES: Actually, before we go to Mr. Bellusci, the 2002-2004 reforms though are different, Mr. Mudge, than the reforms in 863; correct?

MR. MUDGE: I don't think there's a question that the scope and magnitude of the prior reforms were much larger than they are within 863. That's correct.

COMMISSIONER JONES: Okay. And then on the second point you made about why the governing committee majority came out the way they did, you talked about uncertainty associated with all of the regulations that are in process now. But isn't it the case that all of SB 863 or most of SB 863 requires regulations that are in process right now?

MR. MUDGE: I think actually a number of the areas we looked at did not have -- the things that we quantified did not have speculation about what regulations would be. We were fairly clear about what -- at least the intent of the regulations were specifically around things like spinal implant hardware and those types of things.

I will say the biggest area that we have not evaluated and the governing committee is aware of this, we just felt that there was not a way for us to do that at this point in time, is, as I mentioned, the impact of medical as a result of the IMR process that is now included within SB 863.

COMMISSIONER JONES: But estimates of the savings with associated with that were a part of the actuarially indicated rate coming out of the actuarial committee's recommendation -- or actuarial committee's work, were they not?

MR. MUDGE: I'll have Dave clarify what pieces they are, but they were not encompassing the medical treatment component potential effect as a result of IMR.

COMMISSIONER JONES: Okay.

MR. MUDGE: And we think that potentially is the largest piece of IMR but remains to be seen.

MR. BELLUSCI: Well, let me maybe address a couple of questions that were -- with respect to the evaluation of the 2002 through 2004 reforms, which as you pointed out Commissioner, were very different and I don't think any -- Mr. Mudge mentioned I don't think anybody's suggesting that SB 863 has anything close to the kind of scope that we saw in 2002 to 2004.

But with that said, ultimately -- and we put a monitoring process in place as we're suggesting for SB 863 and we regularly monitored. Our most current estimate was at -- basically at 6 -- you know, a two-thirds cost reductions savings; something like $14 billion a year retrospectively. I don't precisely remember the estimate. We certainly have the initial estimate. It's in our latest cost modern report. I just don't have it with me. But my sense of it was probably less than $5 billion in terms of estimated savings and we can confirm that and get that information to you on that question.

With respect to the question on independent medical review which was reflected in the actuarial committee and -- we looked at a number of components. There were the frictional cost impact; essentially, replacing higher cost liens which are very costly to process and medical-legal reports, QME -- qualified medical evaluator reports, that again are very costly, and then an expedited hearing process to resolve medical treatment disputes. We looked at replacing those costs with a much lower cost independent medical review. That was one of the things we priced.

We also, as I mentioned earlier my comments in response to an earlier question, we also looked at the impact of independent medical review on temporary disability duration. We priced that. We also looked at sort of the indirect impact of independent medical review on litigation and there was a price component built in the actuarial committee estimate for that.

As Mr. Mudge mentioned, the one area that there was really no consensus about on what the impact will be and we just -- it was on medical treatment, which potentially is very significant as we know. Workers' comp is in large part a medical benefit delivery system and, you know, that's where the dollars are. But ultimately there was really even no consensus on what the impact would be given uncertainty to the regulations, potential legal challenges, how they're interpreted and implemented, and how medical treatment practices evolve given that you have independent medical review. There really wasn't -- the actuarial committee felt there was no basis to estimate a savings on medical treatment costs from independent medical review.

COMMISSIONER JONES: Due to the level of uncertainty?

MR. BELLUSCI: Due to the level of uncertainty, yes.

COMMISSIONER JONES: Okay. The Mr. Mudge, if I could go back then to the actual process the governing committee used to make this decision. I have to say I'm not persuaded by the comparison to the 2002-2004 reforms because those were so different in kind and in magnitude. But I understand from your testimony and Mr. Bellusci's testimony with regard to the second basis, the uncertainty associated with medical treatment.

But I want to drill down a little bit more on how the governing committee went about making this decision and were there any studies consulted by the governing committee other than the report that came to them from the staff of the WCIRB with the actuarial committee's work? Were there any other studies handed out at the governing committee meeting that they consulted in this deliberation?

MR. MUDGE: Right. There were no other studies handed out at the meeting. There was reference to the work done by Mark Priven at Bickmore Risk Services on behalf of the public members of the governing committee and there was some discussion about the range that Mr. Priven had in his analysis and some alluded to -- uh, that his analysis certainly had a range that was lower than our best estimate of $2.60 at the time. There was no handout of materials but there was a brief discussion about that that the committee was certainly aware of.

MR. BELLUSCI: Let me just add one --

COMMISSIONER JONES: But let me just continue with Mr. Mudge if I could before we go to Mr. Bellusci.

But there wasn't any other than actuarial study, hard copy written actuarial study or analysis, in front of the committee other than what had been done by staff and the actuarial committee at the time this decision was made?

MR. MUDGE: That's correct.

COMMISSIONER JONES: And then, were there any other hard copy reports consulted by the governing committee when it made this decision? Were there -- I mentioned studies, but any other reports other than what was coming up from staff that was available to them at that time that they consulted?

MR. MUDGE: Well, I don't know if it would have been available to each of them as individuals before they walked into the room.

COMMISSIONER JONES: But handed out at the meeting?

MR. MUDGE: No, not handed out.

Right?

MR. BELLUSCI: There was some discussion about some of the results of Texas. I believe that the Texas experience who did have an IMR process back in -- went to an IMR process and did publish a report that indicated savings coming from -- from all their medical reforms including IMR. So there was some discussion of that but I don't believe any of that was handed out at the meeting.

COMMISSIONER JONES: Not the actual -- not an actual report?

MR. BELLUSCI: No.

MR. MUDGE: No, there was no report handed out.

COMMISSIONER JONES: And then -- and so then, was there any other written analysis in front of the governing committee members other than what had been provided as a result of the staff taking actuarial committee's work and making its recommendation to the committee? Any other written analysis at all?

MR. MUDGE: The only written analysis I'm aware of that was provided to them in the committee came from us. So all of our work product that you're aware of.

COMMISSIONER JONES: And then, in the course of their deliberations, did the governing committee re-visit any of the principal assumptions made by the actuarial committee or the staff with regard to the actuarially indicated pure premium benchmark rate?

MR. MUDGE: Well, there was certainly discussion, and I'll let Dave jump in here as well, Commissioner. There was certainly discussion about the potential magnitude of the savings from these reforms we're speaking about how the actuarial committee and staff came to their conclusions; what was the possibility or the range of potential that one could see from savings. So there was a lot of discussion about -- you know, along the lines of -- as you've been asking us, How did we -- How did the actuarial committee do its work? How did they come to consensus on things? What did that mean? We provided detailed by line item numbers relative to the aggregate of the reform benefit that Dave has alluded to -- or mentioned to you earlier.

So yeah, there was a lot of discussion about that. I'm not going to say that the people that are sitting on our governing committee are actuaries who are going to get into an actuarial derivation discussion, but there certainly are long-standing professionals who have experienced things in this industry and they asked, I think, good questions, so -- to our actuaries.

COMMISSIONER JONES: But other than medical -- the uncertainty associated with medical treatment cost savings, were any of the underlying assumptions that underlay the actuarially indicated pure premium rate, were any of those criticized? Were any of those determined by the governing committee to be incorrect? Was there any -- was there any delving into any of the assumptions that underlay the actuary committee's indicated rate other than the uncertainty about medical treatment?

MR. MUDGE: Well, I think there was an unawareness that there's uncertainly around all of the elements in terms of where judgment was made by the actuarial committee. Good actuarially sound judgment, but there's certainly a range of perspective around a number of those. Each item was presented. Each item was discussed.

COMMISSIONER JONES: Were any of them rejected by the governing committee?

MR. MUDGE: None were rejected, no.

COMMISSIONER JONES: Okay. And then -- the other question I have then, is: The $2 billion or so of additional savings that the governing committee in its pure premium recommended rate is assuming will occur on top of the savings that the actuarial committee assumed could be derived on net from SB 863, how is that figure arrived at? that additional $2 billion in savings? Was there any math done by the governing committee members in the course of that deliberation?

MR. MUDGE: I think there was a question -- and I'll let Dave jump in because I think he was asked the question. There was question of how much additional savings would it take if we were to, right, go down the course of path that they ultimately did. And I think Dave provided perspective -- and I'll let him speak for himself here -- provided perspective to the committee on the magnitude of what that would mean; similar to what he just said to you today.

COMMISSIONER JONES: But I guess what I'm -- because you were present at the meeting as well. What I'm trying to understand is: Was there analysis and math done to reach a conclusion that there would be $2 billion in additional savings; therefore, the rate ought to be $2.38? Or was -- did the governing committee just conclude that the rate ought to be $2.38 and the savings is indicated, if you will, as a result of deciding that the rate ought to be $2.38?

MR. MUDGE: I think the decision was more along the lines of: Given the range of uncertainty around the potential savings from these reforms and on top of the areas that have yet to be quantified, that ultimately the majority of the committee made a decision to not adjust the claims cost benchmark.

There was not a math discussion about, If it was this or that, what would that mean in terms of the number?

COMMISSIONER JONES: Okay.

MR. MUDGE: I think it was more along the lines of what I just said.

COMMISSIONER JONES: All right. And then at the time the committee made that decision which was in early October, I believe?

MR. BELLUSCI: September 26th.

COMMISSIONER JONES: September 26th, thank you.

MR. MUDGE: September 26th.

COMMISSIONER JONES: Did the committee have in front of it the current average filed -- industry filed pure premium rates? Or asked a different way: When the committee decided to stick with the -- well, as you just said a moment ago, the committee decided to stick with the 2.38 -- $2.38, uh, previously adopted pure premium rate, what industry average filed rates did the committee have in front of it when it made that decision?

MR. MUDGE: That number.

COMMISSIONER JONES: That number. Okay. But that number was -- I think as you explained in your presentation -- only good as of June 30th. And that number -- that number reflects the industry average filed pure premium rates as of June 30th, 2012; correct?

MR. BELLUSCI: 7/1, yes.

COMMISSIONER JONES: 7/1?

MR. BELLUSCI: Yes.

COMMISSIONER JONES: So July 1st, 2012?

MR. MUDGE: Yes.

COMMISSIONER JONES: So the meeting's in September, but what the committee has in front of it is the industry average filed pure premium rate as of -- as of July 1st. I think you testified a moment ago, though, that if one were to actually update that information, the actual industry average pure premium filed rate as of -- as of today is $2.49; is that correct?

MR. MUDGE: Actually, the number of $2.49 is not a calculation done by us. It was provided to us as a -- I believe, my words -- early indication of filings that the Department has received from a limited set of carriers for 1/1/13, and the Department actually did that calculation and provided it to us.

COMMISSIONER JONES: Let me ask Mr. Bellusci then. With regard to that figure, do you have any reason to disagree that the industry average filed pure premium rate based on filings up to November 1st is $2.49?

MR. BELLUSCI: As Mr. Mudge mentioned, I think it's a preliminary estimate, because many insurers have not yet submitted their filing. But in my mind, I have no reason to believe it's not an accurate reflection of the average pure premium rates that were filed as of this date, but could well change depending on additional filings that are received between now and 1/1.

COMMISSIONER JONES: But it's certainly less preliminary than the industry average filed pure premium rate as of July 1st, 2012, which is what the governing committee had in front of it; right? I mean, that's a preliminary number too? That's even more preliminary because that only has six month's worth of industry average filings. This number, if you don't dispute the number, is updated to include another three or four months or so of industry filings; right?

MR. BELLUSCI: Yes. I think it does reflect additional information beyond the 2.38. And as I said, it certainly is a preliminary indication of where the 1/1, 2013 average industry filed rate will likely be.

COMMISSIONER JONES: Is it better information with regard to where that might be than the information as of July 1st, 2012?

MR. BELLUSCI: Yes. I would say in that it's -- despite the fact it's preliminary, it is more current and does reflect additional information that wasn't reflected in 2.38, so, yes.

COMMISSIONER JONES: And yet the Board didn't have any -- the governing committee did not have that information in front of it?

MR. BELLUSCI: They did not.

COMMISSIONER JONES: Okay. And then finally, Mr. Mudge, you've indicated -- or Mr. Bellusci indicated that the actuary committee in reaching its conclusions with regard to the cost and savings and net savings associated with SB 863 coupled with whatever else is going in the workers' compensation system spent roughly three months working on its analysis, can you tell me how long did the governing committee deliberate on the pure premium benchmark rate that you adopted and recommended to me as a commissioner?

MR. MUDGE: Well --

COMMISSIONER JONES: How long did deliberation in that meeting on that day go on this particular item? Five hours? Six hours? Eight hours?

MR. MUDGE: No. I would say that the basis for their knowledge --

COMMISSIONER JONES: Let me just be really clear.

MR. MUDGE: Sure.

COMMISSIONER JONES: The actual time that they spent in that meeting --

MR. MUDGE: I would say probably somewhere ... Probably between 30 minutes and an hour on the debate of the discussion. Prior to that, there were -- I mean, at least a good hour or more of presentation by staff on material and they all had that material at least a week ahead of time and many of them -- several of them, I believe, were also intimately involved in the evaluations and discussions of the legislation as it was evolving.

COMMISSIONER JONES: Fair enough.

MR. MUDGE: Yeah.

COMMISSIONER JONES: So they had three month's worth of work and they deliberated about it for about 45 minutes?

MR. MUDGE: I can't give you an exact time but

I would say under an hour.

COMMISSIONER JONES: Under an hour. Okay. Very good. I really appreciate your responsiveness to my questions, both you gentlemen. And I know Mr. Bellusci wanted to present some more information to us so we would be happy to receive that at this time, but thank you very, very much. Most appreciated.

MR. MUDGE: Okay. Great.

MR. BELLUSCI: And some of the discussion we just had will -- you know, touches on what I did. So in some of those I'll go -- I'll try to speed it up a bit if we've really talked about it.

So, uh, really quickly, a quick summary of SB 863, we've talked about it already but I did want to kind of highlight some of the -- some of the differences. That the -- the principal part we talked about where there were benefit changes effective both January 1, 2013 and January 1, 2014, those changes as I mentioned will impact costs really without the need for implementation regulations or judicial interpretation. They can be evaluated on a standard, relatively straight forward basis.

Other of the reforms, some of which we've already talked about, require -- were quantified based on the data that was available and in many case judgemental assumptions.

Other provisions that I think these are important to talk about are not quantifiable at this time. They depend on future regulations. Some of those have a potential to significantly impact cost. There's a return-to-work program that's really outside the pure premium process so that's not any cost coming from that is not reflected in this. There are new medical fee schedules for home health, for interpreters, for copy services that remain to be adopted. The hope and intent is probably to reduce medical costs with those new fee schedules. However, we can't value them until such time as we know the values -- until the values are adopted and their -- the legislation requires those adoptions -- those schedules to be adopted sometime during 2013 or later.

And lastly, we talked about independent medical reviews and the issues around that. I think we really talked about already sort of the process we went to value the legislation so I'll skip over those.

Here's a summary of the evaluation that came out of the actuarial committee and, uh, it summarizes the 4.4 that I alluded to earlier in response to a question. This summarizes each of the pieces of the reforms that we've valued. And in total, there's about -- if you look at the 2013 and the 2014 pieces, there's about 1.2 billion in savings. That's offset. I guess it's closer to 1.6 not the 1.7 I mentioned in terms of reforms coming in. The net impact of it that reflects that not all the 2014 benefit increases impact 2013 policies but the net impact on 2013 policies is 4.4 percent.

So let me move -- I think we talked about those. Let me just kind of put a little context around it, and really, in terms of some of the key cost drivers that we're alluding to, that differentiation and claim cost trend with kind of economic growth that Mr. Mudge alluded to. So this looks at loss adjustment expense. Many of the provisions of SB 863 were directed at frictional costs. That's been one of the rapidly -- most rapidly growing cost components in the system as highlighted here. In 2005, we estimated a little less than $6,000 per -- of allocated loss adjustment expense per indemnity claim. By policy year 2013, we're projecting that's grown more than doubled to almost 14,000.

While in our original filing submission made in August, we cited several reasons for that deterioration. First and foremost was a sharp growth in liens. SB 863 introduced a number of provisions related to liens including a filing fee, an activation fee, a statute of limitations. We did reflect in our estimate that there should be a significantly reduced volume of liens filed. In addition, the IMR process should also reduce liens.

Another area we cited were the 2009 WCAB decisions on Ogilvie and Almaraz/Guzman which we've talked about in prior hearings at some length and they impact the permanent disability ratings that are produced for injured workers. SB 863, by eliminating the future earning capacity component in the computation of permanent disability benefits effectively eliminates the impact of Ogilvie. However, SB 863 really doesn't do anything to address Almaraz/Guzman directly.

Another issue we've talked about, the driving costs in prior hearings, is the medical cost containment areas -- area. SB 863 doesn't directly address it but its hope that the new independent medical review and the independent bill review process will reduce some of these frictional costs related to medical.

Lastly, we have indicated in the past that increasing volume of claims over the last couple of years particularly with respect to claims involving cumulative injuries and claims that involve multiple body parts have been driving lost adjustment expense costs, and these areas were not addressed by SB 863.

So in total, a number of the key components leading to the increase and frictional costs were addressed by SB 863, but others were not. Our estimated 863 impact that we provided in filing materials estimates about a 20 percent reduction shown on this slide in allocated loss adjustment expense cost per indemnity claim. This reduces the policy year 2013 from about 14,000 to 11,000.

Now, assuming that the additional SB 863 savings that we talked about earlier that were necessary to produce a pure premium rate equal to that 2.38 that we discussed would have applied proportionately to loss and loss adjustment expense, we would need another thousand dollars reduction in loss adjustment expense coming from the reforms to produce the kinds of savings that are reflected in the pure premium rates.

Going for a similar process for medical, we projected that medical costs for indemnity claim will increase by almost 80 percent from accident year 2005. That was when the reforms of 2002 or 2004 were fully implemented to our policy year projection for 2013 prior to SB 863.

And as with ALAE, we cited a number of factors driving that. First is the cost of medical treatment. As shown in this slide, there were a number of provisions of SB 863 that potentially address medical treatment costs. Some of them these were able to quantify, others were not quantifiable in that they depend fully on future regulation or there was really no statistical basis to develop an estimate.

Rapidly growing lien costs are also driving the increase in medical costs per claim and it was discussed a minute ago. SB 863 did make a number of changes and they are intended to reduce the cost of liens.

Rising medical-legal costs have also driven medical costs. The SB 863 provisions related to independent medical review should curtail some of these.

Finally, we also cited pharmaceuticals and medical care -- Medicare set-asides is driving increasing medical costs and these were areas that weren't addressed by SB 863.

So as with allocated loss adjustment expense, a number of the driving components of medical cost inflation were addressed by SB 863 and others were not. Our estimate that's reflected in 2.61 average pure premium rate reflected about a 5 percent reduction in projected medical cost due to the provisions of SB 863 that we were able to quantify. In order to produce the level of savings as reflected in the 2.38, we would have needed another 8 percent or basically another four or five -- $4,500 or so in savings.

Lastly, I did want to -- and we did talk about this at some length, so I will go through this quickly. I did want to kind of highlight some of the uncertainties and risks involved in this. Again, this is a very atypical filing whenever you have key changes to the benefit delivery system, and they are challenging to evaluate, and there's a wide range of uncertainty. So some of the key things that haven't been evaluated yet, as I earlier mentioned, fee schedules for copy services, home health and interpreters, those may produce additional savings once they're adopted. Ultimately, there's potential savings coming from the conversion of the official medical fee schedule in California to a Medicare-type base, an RBRVS basis. That's a four-year process. So those saving, you know, are somewhat down the road if they materialized.

Some of the risks, we've identified a number here. Some of the key component of SB 863 are potentially subject to legal challenges and the success of those challenges could have a big impact on the savings that materialize.

Lastly, again, the big -- we discussed so much of workers' comp as involved in medical treatment costs. To the extent independent medical review and others impact medical treatment, uh, there are potentially significant cost impact depending on what those impacts are. And those we won't know for some time.

While given all these uncertainties, risks and potential unintended consequences that come with any change of this magnitude, we believe it's critical to be very proactive in measuring those costs specifically as we see them and as they begin to reflect themselves in emerging information. We've already met a few weeks ago with our claims working group, which is a very broad group of researchers, claim people, legal experts, actuaries to build a plan to say, This is what we're going to look for to try to measure some of these key costs. You get some quick hits on what's happening in medical treatment area for example. So we've started to put that plan together. We plan to submit it to you sometime in the first quarter. So that's basically what we wanted to present. We're available to answer any questions you may have.

COMMISSIONER JONES: So I've asked a lot of questions. Let me see if Mr. Dahlquist or Mr. Citko has any questions. Thank you, Mr. Bellusci.

MR. BELLUSCI: You're welcome.

MR. DAHLQUIST: I really don't know that I have much to add at this point. I guess just one question to clarify. In discussing with the -- in the governing committee meeting there was mention that possibly, you know, ranges or, you know, possible -- possible ranges of outcomes were discussed. Did the actuarial staff actually present anything with regards to a range of reasonable estimates around the $2.61 number?

MR. BELLUSCI: There was quite a bit of discussion at the governing committee about sort of the -- the uncertainties and that there is a wide range. But I don't recall that we provided any specific high and low estimate around the best estimate of, you know, the $2.61.

MR. DAHLQUIST: I think I need to ask one question with regards to the $2.38. Well first, what is your -- you know, in your professional opinion, what is the most likely occurrence here? And secondly, what is your professional opinion as to the likelihood that loss cost will actually reach $2.38?

MR. BELLUSCI: Well, let me try to characterize. I think the $2.61 was the best estimate of the actuarial committee through a consensus and I concur. Quite personally and professionally, I think that's a good reasonable estimate. I see no reason to deviate. With that said, there is a wide range of --

as you know, there's a wide range of reasonableness around that estimate. Um, it could like -- it's possible that we could have overstated some of the savings. Some of the legal challenges are successful. Some of the regulations aren't implemented effectively. There is some unintended consequences that we didn't see. So I don't want to give the impression that it's a one-way range of reasonableness. That 2.61 in my mind is the best estimate and I professionally believe that.

But, while there's always a range of reasonableness, I think there's a particularly wide range of reasonableness when you have system changes of this magnitude and all the uncertainties that we've talked about. In my mind 2.38 probably falls within that range of reasonableness. There's some likelihood that it be achieved. But again, I think there's also some likelihood that even the savings we had, we've estimated, you know, doesn't materialize.

MR. DAHLQUIST: Thanks. With regards to the subject of the IMR, I know in the committee discussions -- well, one of the products of the committee discussions was a decision to proceed with a study on the subject. Can you inform us as to the status and the time table of that study and what it's intended to achieve?

MR. BELLUSCI: Yeah. It's evolving a little bit. There was some discussion at the last claims working group on how to kind of attack this question. And just to take a step back, I think the question, Mr. Dahlquist, is alluding to is what we discussed earlier, trying to get an early measure on what the impact of the new IMR process will be on medical costs. Medical treatment costs specifically is the area where there was maybe the greatest uncertainty and the greatest discussion about what that impact would be.

So what we're envisioning is really a three-prong attack at it. First, to get a sense on what's happening in the medical treatment dispute. Two -- there are two pieces to that. We envision doing a survey of insurers as to resolution issues on expedited hearings, taking a random sample of hearings that go to the WCAB on medical treatment disputes and getting a sense on how those were resolved, was the treatment provided, was it not, to get a sense of the current system.

Secondly, we've had some discussions with CWCI, California Workers' Comp Institute, on using some of their transactional medical database to follow the history of utilization decisions -- medical treatment utilization decisions and find out how often were those overturned or how often was the -- you know, six months down the road or a year down the road was the medical treatment provided.

Now, that's two prongs of the estimate trying to get a sense on the current system and really get a better handle on the costs involved and the medical treatment dispute under the current system.

Alternatively, we want to see what's going to happen under independent medical review. And there are a number of things bounced around. And where we -- where we ended up is given that we're, you know, 45 days or something away from independent medical review being the law of land in workers' comp is to work closely with the firm -- the initial firm that likely will be doing the independent medical review as well as the Division of Workers' Comp on getting the results, getting information from actual medical disputes that go through the IMR process.

And we had -- we just started that process. We've had some discussion with Director Baker who's helping develop the regs on what information will be provided from the independent medical review company as well as that independent medical review company and getting a sense on what's available. The time frames we're still working through. We hope to have some information by the first quarter on those pieces. And ultimately, we'll update it as time goes by.

MR. DAHLQUIST: Thank you. I have just one final question for you and we haven't really -- we've appropriately been concentrating mainly on the impacts of SB 863. But getting back to just the basic experience analysis that preceded that, one of the main concerns as I see it is that there's been adverse development. In other words, the accident and loss ratios that the Bureau has estimated have increased fairly consistently over recent successive evaluations.

To what extent is that a concern of yours and what has the Bureau done to deal with that and how does it impact your view of the possible -- you know, I want to say the possibility of experience possibly turning out to be worse than expected?

MR. BELLUSCI: Yeah, a good question. Well, first, we have seen steady deterioration. Now, some of it's due to some refinements in the methodology but even controlling for the methodology we've seen steady deterioration from quarter to quarter in our projections of ultimate basically as a result of payment patterns continuing to slow. So it is a concern. We've done a lot of work in that area. We plan to continue it. But on top of it, we sort of have a new interlay because one of -- one of the by-products of SB 863, if it works as intended, is to speed things up. So one of our first challenges -- and we plan to also look at that in the first quarter -- is try to intermix the impacts of SB 863 with those loss development projections.

Because as you know, not only many of those provisions -- at least we believe at this time or there may be some question, many of those provisions of SB 863 like liens -- provisions related to liens or independent medical review, apply on a date of service basis and so that means there will be an impact not only on future injuries, but also impact to loss development of older years. And with the idea that some of that deterioration, this improvement and speeding up of the claims process could reduce that.

So our first challenge that we plan to look at in the context of when we look -- or in the first quarter in the context of when we look at a potential July 1 filing is to kind of analyze that interaction and see how SB 863 interplays with the normal loss development patterns we have. So it is something that we plan to give a lot of attention to in the next few months.

MR. DAHLQUIST: Okay. Thank you. I don't have any further questions.

COMMISSIONER JONES: Okay. Well, we've been at it for some time and Mr. Mudge and Mr. Bellusci have been on their feet for some time so why don't we take a little break and then what we'll do is we'll reconvene, say, in 15 minutes. And, uh, where are the restrooms in this facility?

(Inaudible)

COMMISSIONER JONES: Okay. So everyone knows but me?

(Laughter)

COMMISSIONER JONES: I want to make sure you knew. It was kind of a test. And so we'll take a 15-minute break which means we'll reconvene at 11:20 and we'll have a chance then to hear from the public members of the WCIRB governing committee and then the rest of the public as well. So we'll take a recess at this point. Thank you very much.

(Recess taken)

MR. CITKO: All right. Let's reconvene. It's 20 minutes after the hour. I do want to remind everyone that we have sign-in sheets out in the foyer. That's for two reasons. One if you would like us to provide you with a copy of the Commissioner's decision, we have your name, address and e-mail. We do like e-mail. It saves trees. The other part of this sign-in is that if you would like to speak, please make sure to mark that on that sheet and we'll have our staff let me know who wishes to speak based on the sign-in sheet. And with that, I think we will proceed.

COMMISSIONER JONES: So I believe next we will hear from the public members of the WCIRB governing committee. And then just so folks know what the rest of the choreography is going to be then, we'll have a chance to hear from I believe the governing committee member's actuary as well. And so, why don't we go to the governing -- the public members. Welcome.

MR. PRIVEN: Thank you. Thank you, Commissioner Jones, Mr. Dahlquist, and Mr. Citko. I'm Mark Priven. I'm an actuary with Bickmore. I sit on the actuarial -- the Rating Bureau -- WCIRB actuarial committee. Just to clarify, I'm not part of the governing committee. I represent the public members of the governing committee on the actuarial committee.

COMMISSIONER JONES: Just so we know where we're going, so will be the public members be testifying too or --

MR. PRIVEN: Yes, they're here. Three or four of them are here.

COMMISSIONER JONES: Okay. So the plan is, you'll go first and then they'll go?

MR. PRIVEN: Correct.

COMMISSIONER JONES: Or -- however you want to do it.

MR. PRIVEN: That's the plan.

COMMISSIONER JONES: That's the plan.

MR. PRIVEN: I'll go first and then they'll go.

COMMISSIONER JONES: All right. I see thumbs up from the public members. Okay. Great. You're on.

MR. PRIVEN: As you know I've submitted written testimony to the Department prior to this testimony -- to this oral testimony. Two sets. One regarding a general commentary on the rates and one specifically on the impact of the reforms of SB 863. So, I don't have a lot of new things to say. I'm just going to sort of summarize what's in that written testimony quickly and then be available for questions and comments.

Overall, I would characterize that my -- my middle projections -- I give a range of projections, a reasonable range from low, middle and high. My middle projections are fairly close to those that were recommended by the Rating Bureau actuarial committee.

Excluding the reforms, I think that the rates are going to be -- or that the rates would have been a little bit higher than what the Rating Bureau actuary said.

Primarily, I have a difference of opinion regarding how losses are trended and also some of the methods used to develop the losses to ultimate. On the other hand counterbalancing that, I believe that there will be greater savings from the reforms than was decided on or agreed to in the actuarial -- in the Rating Bureau actuarial committee. And so the net is -- that the middle of my range is very close to what was recommended by the Rating Bureau actuarial committee.

The reason that I believe that the reforms will result in greater savings than what the Rating Bureau actuarial committee recommended is two things. A smaller part is regarding utilization related to the permanent disability increases. That's a small part. But a much greater part is the impact of independent medical review, IMR, which has already been talked about earlier.

Specifically, where I differ is the impact on IMR on temporary disability and on medical costs. So when we -- when the actuarial committee talked about the impact of IMR on temporary disability, we talked about a few different factors. One is that temporary disability duration has increased over the last five years or so since the prior set of major reforms. And also, that California's duration of temporary disability is greater than that of Texas which has IMR and many other states. And those were sort of used as the benchmark for how much to reduce temporary disability duration for independent medical review.

I will add that I also looked at specifically what happened in Texas when IMR was implemented and I want to caveat this by saying I know California is not Texas. The systems are different. They were different when IMR --

COMMISSIONER JONES: Thank goodness for that.

(Laughter)

MR. PRIVEN: Yeah. Okay. On workers' compensation, I have to say, for example, the results from IMR, we -- you know, if we could replicate those, we would do well. What I saw on temporary disability is that the two years prior to the implementation of IMR, temporary disability was increasing at about 12 percent per year for those two years. And then after IMR, it decreased at about 8 percent per year for two years. That's about a 20 point swing per year for two years. Now, I also want to caveat and say that when Texas implemented IMR, they also implemented other provisions as well. So I'm not saying that this was all due to IMR.

But there were several -- when these reforms happened in the early 2000s, I believe they were passed in 2001 -- late 2001 and implemented in 2002, medical treatment sped up, medical payments sped up, temporary disability decreased, return-to-work increased, and um -- so there was -- and also medical disputes. There were more medical disputes that resulted in denials which you would expect from IMR.

So I -- based on that big change in Texas as well as the deterioration of temporary disability benefits or duration in California as well as the fact that TD duration in California is much higher than in Texas and other states, that I used that as a basis for decreasing expected TD duration a little bit more than the Rating Bureau actuaries did.

Now, let's look at medical. You've already heard today that the Rating Bureau actuaries did not evaluate -- do not feel comfortable evaluating the potential impact that IMR would have on medical costs. The way I look at it, um, what's been happening with medical is analogous to what's been happening with temporary disability.

Specifically, as was shown earlier, medical costs just like temporary disability duration has deteriorated very substantially in the last five to seven years since the prior set of major reforms. Medical costs in California are much higher than those in Texas and in other states. And lastly, if you look specifically at Texas when IMR was implemented, it's almost the same result. The two years prior to IMR, medical costs were increasing at about 12 percent per year and the two years after IMR was implemented, medical costs decreased at about 8 percent per year. So again, it's a 20 percent annual swing for two years.

Now, my projections don't assume anything close to 20 percent savings or even 40 percent savings which you could, you know, potentially talk about if you have two years in a row of 20 percent savings. But I did think that based on that, it's fair to assume that there will be some decrease in medical costs with the implementation of IMR in California.

Okay. So that covers what I wanted to talk about in terms of why my estimates are different -- or how they're similar and how they're different than those of the Rating Bureau. I also want to talk a little bit about the range of estimates because you've asked a lot of questions about that and I just wanted to give you my perspective.

First of all, I was not at the governing -- I was not at the governing committee meeting at the time, so if you have questions about what actually occurred there, I will defer to the public -- to the governing committee public members who will testify after me.

First of all, I want to stress that what I gave is a range of indications. I believe that everything in that range is reasonable. It's a reasonable range and it's based on information and data. Okay? It's not just that the middle of the range is the only reasonable estimate. The entire -- the range itself is reasonable. Okay?

In addition, Mr. Mudge mentioned earlier that one of the topics of conversation was what happened with a prior set of reforms and I realize, Commissioner, you didn't find that particularly valid or persuasive, but I just want to point out that with a prior set of reforms, um, the Rating Bureau was slow to decrease the rates in relation to how fast the cost actually decreased. And, um -- and partly as a function of that, insurance companies were slow to decrease their premiums in relation to their costs to the point where in 2005 over 40 cents on every dollar premium was actually profit for insurance companies. So I just want to repeat that. In

2005, for every dollar of premium, over 40 cents was profit.

So I'm quite sure that the representatives of labor and business who work so hard on these reforms wanted (1) for injured workers to get better benefits and better medical care, and (2) for there to be relief in the cost to the employers. They're not -- they were not particularly interested in boosting up the profits of insurance companies and I'm sure that that weighed on their minds as they were thinking through what appropriate benchmark would be for the Rating Bureau.

In addition, the members of the governing committee -- the public members of the governing committee did have my study which showed a range which was an independent analysis on which to base their analysis and I'll also mention that the State Fund who was there is, you know, obviously the largest insurer in California. If anybody has the ability to do their own independent study based on their own data of what would happen with the reforms, um, if any insurer has that ability, it would be the State Fund. And the information that was out at the time was that based on much greater savings specifically from liens, I believe. And, um, you know, you can even go on their website and see that they're talking about decreasing rates by

7 percent as a result of these reforms. So we're not talking about just keeping rates the same which was voted on by the governing committee. The largest insurer is actually talking about decreasing rates by 7 percent.

I also want to mention -- and this was discussed a little bit, that there are many areas of the reforms that were not able to be quantified. In my opinion those areas are much more likely to decrease cost than to increase costs. We've talked about medical care for IMR, but another big one that has not been mentioned today is independent bill review which is referred to as IBR. I've talked to many employers who are very excited about IBR and potential savings from IBR. And again, that's another issue that was not quantified -- that was not able to be quantified by myself or by the Rating Bureau in general in terms of the savings. But I do believe that -- if anything, that will result in savings as opposed to additional costs.

That's all I want to say about the range. I just have two more small points I just want to bring up and then open up for questions. One is, I just want to go on record in recognizing that these reforms have produced somewhat of a windfall for insurers. By that I mean, all we're talking about right now is rates for prospective policies but we're not talking at all about their retro impact -- the retroactive impact of -- the retrospective impact of the reforms. The costs -- the costs that will increase as a result of other reforms for the most part are only related to injuries which will occur after January 1st, 2013. That's where the new permanent disability cost schedules kick in.

On the other hand, some of the savings specifically related to liens and related to IMR, once they're implemented will affect open claims. And so, we haven't talked about repricing old -- you know, existing policies or anything like that, but I just -- I think it needs to go on the record that insurance companies are receiving a benefit. And self-insured employers and employers in large deductible programs are receiving a benefit from this reform that goes beyond just the future cost of future policies.

The last thing I want to mention is that I believe that this reform will also help to reduce not only the cost next year and the year after, but, um, it should also slow the rate of inflation of workers' compensation in the future. Because the areas of the workers' comp system that have been inflating quite quickly, specifically loss adjustment expense, medical and other -- other expenses, are being -- are decreased as a result of the reforms whereas the area of workers' comp that tends to inflate at a lower rate is indemnity and that area has been increased. So the whole pie -- if you think about how the rate at which an entire pie grows, it should grow at a lower rate because of that factor.

That's all I have for my prepared remarks if you have any questions.

COMMISSIONER JONES: Let me start with something and then let me go to Mr. Dahlquist.

MR. PRIVEN: Sure.

MR. DAHLQUIST: First, I appreciate your presentation. We have your written materials. If you've got any slides, we can throw those up to but --

MR. PRIVEN: I didn't bring any.

COMMISSIONER JONES: Okay. Very good. So I was struck by a number of things that you said. You mentioned that State Fund was at the governing committee. But again, let me just pose the same question to you that I posed to Mr. Mudge and Mr. Bellusci: Did State Fund provide any written analysis to the governing committee members in their deliberation with regard to the pure premium rate filing?

MR. PRIVEN: I wasn't there so you'll have to --

COMMISSIONER JONES: Okay. But you're not asserting that they did; right?

MR. PRIVEN: No.

COMMISSIONER JONES: All right. You have no information contrary to what Mr. Mudge and Mr. Bellusci said which was that there was no other written report, analysis or anything other in writing provided to committee members other than what the actuarial committee provided? You're not asserting there was some other information in writing given, are you?

MR. PRIVEN: Correct.

COMMISSIONER JONES: Okay. Then, I take your point with regard to returns associated with 2002-2004 reforms. The only thing I would note is, you know, I've said, uh, publicly and I've said to the stakeholders that were involved in this set of reforms that perhaps the best way that they could avoid that sort of outcome again would be to include language in SB 863 or whatever set of reforms has done which would essentially work to make sure that there wasn't a windfall associated with some level of cost savings beyond that which was projected. And for whatever reason, no one seemed to advocate for that, but I don't -- I -- I mean, is it your position that I'm allowed to consider the question of whether there might be excessive returns in the context of deciding what the pure premium rate benchmark should be?

MR. PRIVEN: I'm trying to provide a context within which I think some of the decision-makers were voting.

COMMISSIONER JONES: Okay. That's fair. But I just want to point out, I'm governed by a body of law that says that I have to do this process and cabins what the process is. And I might wish that were different, then I can take other things into consideration, but the law tells me what I have to look at for purposes of making this advisory opinions. I appreciate your point and I appreciate you weren't -- you weren't arguing that I can take into consideration that issue of potential windfall in the context of setting pure premium.

MR. PRIVEN: When I mentioned windfall, I was talking about, uh -- I was talking about the impact of the reform on -- you know, on claims which have already occurred. I'm not sure if you're talking about the prior set of reforms and the profit that was made from those as a windfall or are you talking about --

COMMISSIONER JONES: No, I'm talking about --

MR. PRIVEN: -- the retrospective --

COMMISSIONER JONES: I'm talking about both. I'm talking about both actually.

MR. PRIVEN: You're talking about both?

COMMISSIONER JONES: Yeah.

MR. PRIVEN: Well, the former -- in terms of the profit from the prior set of reforms, I think that's just a context, you know, in terms of what people are thinking about when they're looking at what a reasonable rate is and how to treat a range? When you have a reasonable range in front of you, how do you consider where in that range you want to be? Uh, you look at some prior experience and say, Well, what happened last time? Okay? That's -- I'm just trying to give some context on that.

COMMISSIONER JONES: Sure.

MR. PRIVEN: In terms of the retrospective impact, yeah, no, I don't think that's, uh -- that's -- that's not -- I wasn't bringing that up in the context of what a prospective rate should be.

COMMISSIONER JONES: Okay. And as we sit here right now, what are the combined ratios in the industry?

MR. PRIVEN: I don't know exactly, but in the 1.30s? Is that right?

MR. BELLUSCI: Our latest assessment in the last three years at 1.38.

MR. PRIVEN: 1.38.

COMMISSIONER JONES: Okay. So the import of that is, is that for every dollar premium to be pulled in, the carriers are paying out a buck 38?

MR. PRIVEN: Correct.

COMMISSIONER JONES: I don't have any other questions. I appreciate your testimony. Thank you.

MR. PRIVEN: Sure.

MR. CITKO: Real quick. Before you start on that, let me just -- there are a couple of items with what you said. When you talk about a range, there's probability of what may occur within that range, and does your analysis include that?

MR. PRIVEN: No, I didn't assign specific probabilities to them. What I did is I looked at reasonable methods, reasonable assumptions, and whatever came out of those sort of defined the reasonable range. But I didn't -- it wasn't like a statistical analysis of, you know, 10 percent chance it could be at the bottom of the range, 10 percent chance at the top of the range; anything like that.

MR. CITKO: Okay. But yet there's some probability that would be attached to those items that you've noted in your analysis whether they would occur within that range based on some of the factors that the Rating Bureau brought up such as litigation; is that correct?

MR. PRIVEN: I'm sure there is a probability but I didn't calculate it.

MR. CITKO: The other thing is, you did point out the prior reforms and the fact that the Rating Bureau's estimates were short of what the actual reduction in costs were from the prior reforms. But as I recall from prior reforms, there were some studies, for example, on permanent disability and some of them were roughly close to what the savings was going to be.

MR. PRIVEN: Right. Like Dr. Brigham? Is that what you're --

MS. REPORTER: Like doctor who?

MR. PRIVEN: Brigham's, sorry.

MS. REPORTER: Thank you.

MR. CITKO: Yeah, Brigham's study.

MR. PRIVEN: Brigham's, yeah.

MR. CITKO: Do we have anything similar to that presently that we can draw upon for -- other than the Texas example that you've cited?

MR. PRIVEN: Right. I think -- I think -- looking -- and I believe Texas is really the best example in terms of what would -- you know, if you want a case study of what could possibly happen in California. I haven't found any other states that would be a better example. So you could certainly look at Texas. And in addition, I believe State Fund would probably provide you with some information on liens that might -- might not be the same as what myself or the Rating Bureau or the CWCI is saying.

MR. CITKO: Yeah. But we don't have the information from State Fund or from anybody else on liens this at this point in time.

THE WITNESS: Okay.

MR. CITKO: Okay. All right. Well, I didn't know. Because you were saying -- and I didn't know if there was some data out there or some study that was being done by State Fund that you may be aware of.

MR. PRIVEN: Yeah.

MR. CITKO: Okay. All right. Well, thank you.

MR. DAHLQUIST: Okay. I would like to start with your evaluation of the basic experience.

MR. PRIVEN: Okay.

MR. DAHLQUIST: Without getting into extreme detail but I would like to, you know, get some -- some explanation on that. I'm talking about the basic experience analysis that determines the pure premium rate mean absent the impacts of SB 863.

Am I correct in reading your report that your low estimate is the same as the Bureau actuarial staff estimate?

MR. PRIVEN: For loss, correct.

MR. DAHLQUIST: For loss?

MR. PRIVEN: Correct.

MR. DAHLQUIST: Loss adjustment expense, I understand it's slightly different.

MR. PRIVEN: Correct.

MR. DAHLQUIST: I don't know that we need to get into that.

Can you briefly summarize why your middle estimate is different? What are the -- just briefly what are the major differences?

MR. PRIVEN: Sure. As I mentioned there's two main components. One is the method that was used -- or that's used to calculate ultimate losses for prior years. So the projections for the future are based on two things. (1) the projection of ultimate loss for the prior years. And then (2) what we call a trend which is the adjustment of how the -- how the older years are adjusted for inflation and other factors to how they might portend for the future year. So both of those factors are different in my -- in my middle projection.

Regarding the projection of ultimate loss for the older years, the Rating Bureau projections are based strictly on paid losses, developed to ultimate. In my -- what I was looking at, is that -- I think this was alluded to earlier today, that -- and you brought it up, that the ultimate loss projections using the paid method have deteriorated over time. Every time we get more data, we look back at those older years and we realize that they're actually worse than we thought they were or the costs are higher than we thought they were.

And so, I looked at some of the other methods that were calculated and provided by the Rating Bureau and I looked at the -- specifically, the incurred loss development method and it seemed to me that those loss projections have been a lot more steady; that they haven't deteriorated in the same way that the paid loss projections have. And so, I gave those some weight in my projections of ultimate loss. And the incurred loss is not only more steady but they actually are higher projections of ultimate loss. So that caused my projections to be higher. That's the first thing.

The second thing is the trend factors which is how we get from the older years to project for the new -- for the upcoming year. Um, the Rating Bureau I believe uses two methods -- 50/50 weight on two methods. One is looking it at the total cost rate; you know, the total losses -- or the total pure premium or loss rate trended with an exponential trend, and that's given half weight. And then the other 50 percent weight is given to an independent analysis of frequency and average claim size.

And again, when I look at it, I see that there's been a big change -- and this is been reported by the Rating Bureau that there's been a change in indemnity claims -- between medical-only claims and indemnity claims. And that -- because the frequency in average claim size statistics are done on indemnity claims only, that change in mix from med-only to indemnity is kind of in my opinion wreaking havoc with both the frequency and the average claim size statistics. It makes it look like there's a lot more claims so the frequency is going up, and on the other hand, they tend be smaller claims so it's dampening the average claim size. So when you try to project independently frequency and independently average claim size, you wind up with kind of a mess because they are correlated with each other with these small claims becoming indemnity claims or not remaining medical-only claims.

Um, and so what I did in my projections is not relied at all on the frequency-severity method and relied strictly on the loss ratio method -- losses total trending using exponential trend, and that also resulted in a higher projection.

MR. DAHLQUIST: All right. Thank you.

MR. PRIVEN: Okay.

MR. DAHLQUIST: What was the net in -- what was the combined effect then or these methodological changes? What percentage-wise, and if you can, dollars-wise approximately?

MR. PRIVEN: Well, it's about a 6 percent increase in total. I don't -- I don't know. I don't know what the dollars are.

MR. DAHLQUIST: Well, six percent then?

MR. PRIVEN: Six percent, yeah.

MR. DAHLQUIST: Okay. How did you arrive at your high-end estimate for the basic loss experience?

MR. PRIVEN: For the basic loss experience -- well, both the -- well, okay. So both the ranges, the low and the high, were based on the projections. But the different methods were provided by the Rating Bureau. The Rating Bureau provides not only the two methods for projecting ultimate loss that I've alluded to, the paid method and the incurred development method, they provide -- I don't know -- a dozen or so different -- different methods of projecting ultimate loss. And so I looked at the range provided by those different methods and based it on that.

MR. DAHLQUIST: Was that just a judgemental selection or can you point to --

MR. PRIVEN: I'd have to go back and look.

MR. DAHLQUIST: -- any particular --

MR. PRIVEN: I'd have to go back and look and see exactly which methods I weighted together to get to that.

MR. DAHLQUIST: Okay. Would you say it was some -- I mean, the filing itself certainly has the results of those methods. How would you characterize where your high-end estimate fell within the range of those estimates provided by the WCIRB?

MR. PRIVEN: It was I guess towards the top but not at the top.

MR. DAHLQUIST: And percentage-wise, what impact did that have?

MR. PRIVEN: Um, about 4 percent.

MR. DAHLQUIST: Okay. So then you're saying -- if I -- if I'm understanding this correctly, your middle estimate on the basic loss experience as you think it's 6 percent worse than the Bureau actuarial estimate and your worst case is 4 percent higher than that? I mean, your highest --

MR. PRIVEN: I wouldn't say worst case but --

MR. DAHLQUIST: Your high estimate. Excuse the --

MR. PRIVEN: Yeah.

MR. DAHLQUIST: Excuse the choice of words there.

Okay. Moving on to the SB 863 impacts. I was not able to see what the basis was for your high estimate. By that, I mean the low savings that resulted in, you know, the higher end of estimated costs.

MR. PRIVEN: I'm sorry. Which one? Which end of the range are you --

MR. DAHLQUIST: You provided -- you provide an estimated, uh -- an estimated impact --

MR. PRIVEN: Oh, I see --

MR. DAHLQUIST: -- of SB --

MR. PRIVEN: Right.

MR. DAHLQUIST: -- 863 in total and --

MR. PRIVEN: Right.

MR. DAHLQUIST: -- you've got a low, middle and high, and I want to know how you arrived at the high end.

MR. PRIVEN: Right. So that was primarily based on the independent medical review. I feel -- and I concur with -- you know, with Mr. Mudge and Mr. Bellusci who testified earlier. That's one of the most difficult areas of this reform to price. And, um -- so I'd say the lion's share of the range that was developed on the high end was less optimistic saving's projections from IMR. Is that what you're asking?

MR. DAHLQUIST: That is -- I mean, that's a general answer to what I was asking.

MR. PRIVEN: I mean, I'd have to off-line just give you, you know, X percent for medical, X percent for TD or whatever. I don't have that handy.

MR. DAHLQUIST: So you did, uh -- you did make some choices but you're not prepared to say exactly where that came from?

MR. PRIVEN: Correct. Right. But I'd be happy to provide those to you.

MR. DAHLQUIST: Okay. I think I understand, you know, what -- how you got at your middle. But with regards to your middle estimates, you're essentially -- you are essentially looking at how the Texas experience changed when IMR was implemented and you're --

MR. PRIVEN: Well, there were -- again, there were three things and these were discussed at the actuarial committee. One was, How did California change after the prior set of reforms? And we'll use temporary disability as an example. How much did temporary disability benefits increase or duration increase after the reforms? So that was one benchmark.

Another benchmark was, How much higher is California duration of temporary disability benefits compared to other states?

And then the third thing was looking at Texas and when they implemented -- when they implemented IMR, did they at least see, you know, results that were at least as -- that showed at least as much savings that might be implied by those other two?

MR. DAHLQUIST: But the actual savings that you -- what I --

MR. PRIVEN: Right.

MR. DAHLQUIST: -- read is that you observed a 20 percent reduction -- or 20 percent savings in Texas and you're assuming some portion of that would happen in California? I think there's a couple of parts to that, but is that --

MR. PRIVEN: That's part of it. Right. There's also -- as I mentioned, so for example, the duration of temporary disability benefits in California I think it's like 12 percent higher in California than Texas or the median of other states or something like that. So that was discussed in the actuarial committee as a benchmark of how much temporary disability benefits might decrease with IMR to bring it down to the level of other states or in another state that has IMR. Now, neither I nor the Rating Bureau actuarial committee assume that temporary disability benefits would decrease by 12 percent and didn't take all the way down there, but that was one benchmark.

Another benchmark was, How much did temporary disability benefit's duration increase post reform? I believe that was ... I can't remember exactly. Maybe 25 percent?

MR. BELLUSCI: Twenty-five percent maybe.

MR. PRIVEN: Yeah. We're not sure but it was a very substantial number. And again, let's say it was 20 or 25 percent, none of our projections were that temporary disability benefit's duration would decrease by 25 percent by IMR, but we did use that as a basis for a range.

MR. DAHLQUIST: With regards to the duration issue, how much -- you've attributed some savings specifically to that. How does your estimate compare to what is in the WCIRB actuarially indicated?

MR. PRIVEN: Well, mine's definitely higher. I assumed, I believe a 10 percent decrease. The Rating

Bureau assumed like a 7 percent?

MR. BELLUSCI: I think it's five.

MR. PRIVEN: Five. Okay. So that would mean that my estimate is roughly double that of the Rating Bureau on temporary disability.

MR. DAHLQUIST: How many -- how much would that be in dollar terms?

MR. PRIVEN: Help.

MR. BELLUSCI: Um, 400. About 400 million.

MR. PRIVEN: Four hundred million. I'll rely on --

MR. DAHLQUIST: The 400 million -- $400 million difference or $400 million --

MR. PRIVEN: Oh, I'm sorry. The difference is 200 million.

MR. DAHLQUIST: Thank you.

MR. PRIVEN: Again, I'm relying on --

MR. DAHLQUIST: Okay. Okay. With regards to the, um -- where do I want to ... With regards to the medical cost savings --

MR. PRIVEN: Right.

MR. DAHLQUIST: -- explain what you did. You know, how you used the Texas experience?

MR. PRIVEN: Uh, okay. So again, there's three sort of benchmarks. You asked about the Texas experience so I will give that as the first answer.

Um, as I mentioned before, Texas had about a 12 percent rate of increase in medical cost per year the two years prior to their reform, and then they saw on average 8 percent annual decrease after the reform. So it was similar to temporary disability in terms of the magnitude of the change.

As far as -- the second component of the -- of what I looked at is how much did medical costs increase post the 2002 through 2004 reforms? And I think we had a slide on that. It was about 79 percent was how much medical has deteriorated or costs have increased post reform.

And then the third thing -- then the third factor is how much -- how California medical costs compared to those of other states? And that's -- I don't remember the number exactly but I'm sure it's at least 50 percent higher and I'm basing that on, I know, the Oregon study of California rates shows it were about 50 percent higher than the median. And I know we have a higher percentage of our total costs are medical than most other states, so.

So, those are the three benchmarks. If I had looked at it just like I looked at TD, I think I could have justified a 10 percent savings because that's what

I came up with TD. But I recognize that the medical is -- is -- it's a little bit -- there's a lot of other things going on with medical than just IMR.

And the other thing is that, I think it's about 400 million of -- over $400 million of medical costs are under dispute, and so it didn't make sense to show savings that were wildly higher than $400 million. And so I arrived at a number of 5 percent for medical as opposed to 10 percent for temporary disability.

Does that address your question?

MR. DAHLQUIST: I think so. How similar are the provisions of SB 863 with regards to IMR to what was enacted in Texas? Have you considered that?

MR. PRIVEN: Yeah, and -- well, first of all, we don't have the regulations for SB 863 on IMR yet. But my understanding from the folks that I have talked to about that is that it's meant to be pretty similar.

MR. DAHLQUIST: Okay. What considerations have you given to -- I mean, how -- to the similarity -- similarities or differences between the Texas environment and the California environment just in terms of just the whole workers' comp system and how that might affect -- how IMR plays out in the system?

MR. PRIVEN: Yeah, it's hard for me to speak to that. But I will say what I considered is that when, um -- when the reforms were implemented in Texas, it wasn't just IMR. I mean, they kind of do it like we did, right? I mean, we just don't implement IMR. We implement several reforms at once; both the SB 863 and then when we implemented the prior set of reforms. We -- we changed many parts of the system at once. And so when I looked at the Texas system versus the California system and I tried to figure out what was going on with the Texas system when IMR was implemented, I recognized that there were several parts of the reform that would impact medical. There were some things on spinal surgeries, second opinions and so forth that would also impact medical. And so I didn't -- so when I looked at the savings from the reform, I sort of cut those back in recognition that there were some parts that were not directly related to IMR.

You know, I did as much research as I could on what was going on in Texas. I couldn't find a report that specifically broke out, you know, This is the savings from IMR, This is the savings from spinal, second opinion, and so forth. So I wasn't able to, um -- I wasn't able to sort of isolate. So I just had to sort of judgmentally bring it back.

MR. DAHLQUIST: Okay. Do you have an opinion as to, you know, what might be the greatest IMR -- the greatest percentage of that that might be due to IMR reasonably?

MR. PRIVEN: The greatest percentage of what?

MR. DAHLQUIST: There's some -- I'm assuming there's some variability in your estimates of what the impact of IMR might be.

MR. PRIVEN: Right.

MR. DAHLQUIST: And I'm asking what you observed the 20 percent reduction --

MR. PRIVEN: Per year for two years?

MR. DAHLQUIST: -- for you to assume that out of 20 percent, 5 percent would be IMR? The question is: Did you or do you have a feel for how -- I mean, what's the largest reasonable percentage that might be contributable?

MR. PRIVEN: See, I wouldn't be surprised if it's over 10 percent. I mean, when I looked at the different provisions in the reform, it seemed to me that IMR was the most -- would be the most impactful. And from conversations with people, that was my understanding. And so, um -- so I would say over 10 percent.

MR. DAHLQUIST: Okay. So you explored the basis for your central or middle estimate. What assumptions underlie -- how did you arrive at your maximum -- your low -- your maximum savings, lowest cost estimate? Your lower bound if you would?

MR. PRIVEN: Right. So again, I'll have to -- you know, I'll have to give you what the exact assumptions were. But the bulk of it was different assumptions regarding IMR. I agree with the Rating Bureau that that's very difficult to project the savings from IMR, and so the low end of my range in terms of the low-end rates assumed a greater impact of IMR and the higher rates assumed a lesser impact of IMR. The bulk of it. I mean, there were other things too. But the bulk of it was the impact of IMR both on temporary disability and medical.

MR. DAHLQUIST: Okay. I want to explore the concept of the range now a little bit as a follow-up to Chris's question earlier.

MR. PRIVEN: Okay.

MR. DAHLQUIST: You said earlier -- well, I guess, could you repeat for us what you said earlier about, um --

MR. PRIVEN: I bet she could. I'd feel better if she did.

(Laughter)

MR. DAHLQUIST: I'll ask first: What's your opinion as to what is the most likely occurrence within your range?

MR. PRIVEN: I'll say if you -- of those things that we can quantify, the most likely is what's in the middle of my range. However, I do think that the middle is biased upwards in terms of that the rate is biased high because there are provisions that we weren't able to quantify and I believe that those provisions will on balance decrease costs in most particularly independent bill review, IBR.

MR. DAHLQUIST: Okay. I'm ... All right. Do you think that every point in that range is equally likely?

MR. PRIVEN: Is equally likely? Uh, no.

MR. DAHLQUIST: How likely do you think the top and the bottom ends of the range are?

MR. PRIVEN: Yeah. Like I said to Mr. Citko, I didn't assign probabilities to the ends of the range so I don't have -- I don't have an answer to that.

MR. DAHLQUIST: Would it be fair to say that the likelihood of the lower end of the range -- how to put this? You've got an entire range; right?

MR. PRIVEN: Correct.

MR. DAHLQUIST: What is the likelihood -- just comparing, what's the likelihood of the lower end of the range happening versus the likelihood of any point higher than the lower end of the range happening?

MR. PRIVEN: I think the lower end is more likely, because as I mentioned, the range was developed -- the mid point was developed excluding certain provisions which I couldn't quantify. But I believe on balance that those provisions will end up in savings. And so, I believe that mid point is biased high and that I believe that the lower end of the range is more likely to occur than the higher end of the range.

MR. DAHLQUIST: Okay. But putting it another way, $2.38 versus the other choices, $2.39 and above, which is more likely?

MR. PRIVEN: I feel like I'm on Price is Right.

(Laughter)

MR. PRIVEN: Come on down.

(Laughter)

MR. PRIVEN: Uh, 2.38 is less likely. Is that what you're --

MR. DAHLQUIST: All right. I think what I'm really driving at is, if you were to assume that every point in the range was equally likely --

MR. PRIVEN: Yeah.

MR. DAHLQUIST: -- is it not the case that if you choose the lower end of -- the lowest point in the range that you are assuming something -- you're implicitly setting your choice at something which you believe is, you know, perhaps ... Well, that it's most like -- that every other point in the range is ...

MR. PRIVEN: If you chose the lowest point in the range which is not --

MR. DAHLQUIST: If you chose the lowest point of the range, are you not -- well, let's say you had 100 points. It was discrete, not continuous.

MR. PRIVEN: Right.

MR. DAHLQUIST: Everyone was 1 percent likely. Are you not assuming a 99 percent probability that what will actually happen will be worse than what you've chosen?

THE WITNESS: Yes. However, I just want to point out that what was voted on and approved is not the lowest point in my range. The lowest point in my range is minus 2.6 percent not zero.

MR. DAHLQUIST: Well, minus 2.6 percent relative to ...

MR. PRIVEN: Relative to the filed rates as of 7/1, 2012.

MR. DAHLQUIST: Is that 2.38 or is that a number higher than 2.38?

MR. PRIVEN: The lowest side of the range?

MR. DAHLQUIST: Yeah.

MR. PRIVEN: Is 2.38 the zero?

MR. DAHLQUIST: Okay. Yeah.

MR. PRIVEN: Yeah, so it's lower than the 2.38.

MR. DAHLQUIST: All right. I think I'm done. Thank you.

MR. PRIVEN: Okay.

COMMISSIONER JONES: I just have a couple more questions.

So do I understand you to say that in your initial analysis prior to considering the net cost savings associated with SB 863, that you came up with an actuarially indicated pure premium rate higher than what the WCIRB actuarial committee's indicated rate was?

MR. PRIVEN: That is correct.

COMMISSIONER JONES: And that rate is -- I'm trying to remember from your papers -- but 2.87 per $100 of payroll?

MR. BELLUSCI: 2.73 I think it was.

COMMISSIONER JONES: Okay. But I want -- I got to get it from Mr. Priven because it's his testimony.

MR. BELLUSCI: Sorry.

COMMISSIONER JONES: That's okay.

MR. PRIVEN: Well, I'm just going to read it off of what they --

COMMISSIONER JONES: All right. But it's your analysis, so hopefully --

MR. PRIVEN: Yeah. So my -- the indicated -- the Rating Bureau indicated average rate excluding the impact of the reforms I believe was 2.73. Is that right?

COMMISSIONER JONES: But yours? What is yours?

MR. PRIVEN: And so mine -- I don't have the exact number but mine is roughly 6 -- 6 percent higher than that.

COMMISSIONER JONES: Okay. Well, I think this underscores why I'm going to ask in a moment that one of the Department's actuaries come up and put these various numbers up on the screen so we can keep track of it all. But -- so you were higher than what they were -- what the WCIRB actuarial committee was indicating the rate would be prior to considering the SB 863 reforms. But the way that you get to a lower-middle range number is by, if I understand correctly, considering what happened in Texas and drawing from that to conclude that both with regard to cost savings associated with temporary disability and cost savings associated with medical treatment, um, that those costs savings are greater than what the WCIRB actuarial committee indicated and so that's how you get to your middle range figure of $2.61; is that correct?

MR. PRIVEN: No.

COMMISSIONER JONES: No. Okay.

MR. PRIVEN: First of all, my middle range number is very close to what the Rating Bureau actuarial committee number recommendation was.

COMMISSIONER JONES: Yes. But what I'm trying to understand, again, is how you get from the higher initial cost --

MR. PRIVEN: Right.

COMMISSIONER JONES: -- SB 863? You got a wider gap to bridge?

MR. PRIVEN: Right. So, it's true that it's primarily based on my evaluation of independent medical review but that is not based solely on Texas. As I mentioned, that was based on how much temporary disability and medical costs deteriorated since the reforms. It was based on a comparison of California and other states, and also what happened in Texas after the implementation of IMR.

COMMISSIONER JONES: Okay. But in all three of those areas, your conclusion is that there will be greater cost savings associated with those things and what the WCIRB actuarial committee did, because you got to bridge a wider gap between their pre-SB 863 actuarially indicated pure premium rate and yours. Does that make sense?

MR. PRIVEN: I don't know you what mean by --

COMMISSIONER JONES: You said --

MR. PRIVEN: I don't know what you mean by, Have to bridge a wider gap? But yes --

COMMISSIONER JONES: Well, you do I guess.

MR. PRIVEN: I am --

COMMISSIONER JONES: You do have to. But you start from a higher --

MR. PRIVEN: I have a higher savings --

COMMISSIONER JONES: Right.

MR. PRIVEN: -- from the reforms than what's implied -- than what's calculated by the Rating Bureau actuaries primarily based on my evaluation of IMR. Correct.

COMMISSIONER JONES: Okay. And what's the total absolute dollar value associated with those savings to get you from where you start pre-SB 863 actuarially indicated pure premium rate to where you end up in your middle range projection with regard to the actuarially indicated post-SB 863 pure premium rate?

MR. PRIVEN: Okay. So, um, I'm not sure I have the exact number to answer your questions. But I have -- on my written testimony to you, um, I have the -- I have the exact savings from the reform for accident year 2013; i.e., injuries which are projected to incur in 2013, and that savings including utilization is 1.77 billion.

COMMISSIONER JONES: That's the same figure I heard earlier from the WCIRB that they're -- they're concluding will result from the SB 863 reforms.

MR. PRIVEN: Okay.

COMMISSIONER JONES: That is their actuaries concluded. The actuarial committee concluded would occur from their SB 863 reform. So I don't understand why your cost savings number isn't bigger because you start from a higher point.

MR. MUZZARELLI: Different law space.

MR. PRIVEN: Yeah, that's probably true. I mean, we're -- everything gets converted to percentages. I have my own estimate of how I think the size -- what I think the size of the entire workers' comp pie is, what the entire market is. And I'm going to base my -- you know, I project the savings, and then to get a percentage, I take my savings as a percentage of the entire pie.

The Rating Bureau not only has different estimates of the savings but they also have different estimates of what the entire pie is. So that when you take a ratio of those two, you can end up with different percentages. Not only because the savings estimates are different but also because the estimates of the size of the pie are different. Does that help?

COMMISSIONER JONES: Okay. That's helpful.

MR. PRIVEN: Okay.

COMMISSIONER JONES: But then to get from your --

MR. PRIVEN: Thank you.

COMMISSIONER JONES: To get from -- so what's the -- what's the additional absolute dollar value of savings associated with moving from your middle range pure premium indicated rate to your low range pure premium indicated rate?

MR. PRIVEN: So it's about 12 percent and -- what's the volume of the insured market? Is it about one - 12 billion?

MR. BELLUSCI: Yeah. The dollars I think

are --

MR. PRIVEN: Are you talking about the insurance world or the entire -- the entire California market including self-insurance and --

COMMISSIONER JONES: Well, I'm trying to figure out what additional increment of savings in the system you're assuming to get from your middle range to your lower range pure premium indicated rate?

MR. PRIVEN: And when you say "system," you're including self-insurance and --

COMMISSIONER JONES: It's your analysis. So I don't know what you're assuming. But my question is: How much additional savings is associated with moving from your middle range to your lower range?

MR. PRIVEN: I'm going to say it's roughly 1.2 billion which would be -- it's 12 percent roughly and I'd say that the pure premium is roughly 10 billion. And so, I'm just -- as a rough estimate, I'll say 1.2 billion.

COMMISSIONER JONES: And so, where does that come from? Because you're already -- your analysis concludes that there are going to be cost savings associated with SB 863 --

MR. PRIVEN: Right.

MR. DAHLQUIST: -- in addition to those that are --

MR. PRIVEN: Right.

COMMISSIONER JONES: -- identified by the actuarial committee in its analysis.

MR. PRIVEN: Correct. Correct.

COMMISSIONER JONES: And so you point to these three factors that you've testified to.

MR. PRIVEN: Correct.

COMMISSIONER JONES: One of which includes the Texas experience, but now you're going even further --

MR. PRIVEN: That's right.

COMMISSIONER JONES: -- to get to your low range estimate. And so, where are those -- where do those cost savings come from and what is the actuarial basis for concluding that those cost savings will accrue?

MR. PRIVEN: Okay. So I realize I misspoke. What I was comparing was the low end to the middle end of the range including both the impact of the reforms and the non-reform. Okay? So if you start out with what my estimates are excluding the reforms, uh, as we mentioned, mine are substantially higher than those of the Rating Bureau's. So at the low end of the range, I'm assuming that the Rating Bureau projections excluding the reforms are correct.

COMMISSIONER JONES: Oh, my goodness. So you change your underlying assumptions to get to your low end of the range?

MR. PRIVEN: Yeah. Well -- yes, so --

COMMISSIONER JONES: So you have an assumption for purposes of the high end and the middle end --

MR. PRIVEN: Yeah.

COMMISSIONER JONES: -- that the cost and system are going to be higher --

MR. PRIVEN: Right.

COMMISSIONER JONES: -- over -- as a starting place? But then to get to your low range estimate, you then assume --

MR. PRIVEN: Correct.

COMMISSIONER JONES: -- the WCIRB's estimate --

MR. PRIVEN: Correct.

COMMISSIONER JONES: -- for overall system costs and take that as a starting place?

MR. PRIVEN: Correct.

COMMISSIONER JONES: Why? I mean, if you're so --

MR. PRIVEN: Because I think that they're -- I think it's reasonable. I mean, I think -- I don't think -- personally, I don't think that's the most likely outcome but I think that what they did is reasonable and so I think it should be included in the reasonable range.

COMMISSIONER JONES: Okay. So then, that explains then -- so that explains then how you -- you -- you start from a different starting place with regard to --

MR. PRIVEN: Absolutely. So that's six points right there --

MS. REPORTER: Hold on.

(Brief discussion)

COMMISSIONER JONES: Why don't we go back on?

Can you read back the last question?

(Record read)

COMMISSIONER JONES: So the question is that: With regard to your lower end of the range you start at a different starting place? You start from the WCIRB's starting place with regard to the state of the system pre-SB 863 and then you apply the additional cost savings that you concluded will occur as a result of Texas and the two other factors that you've testified to to get to the low end of your range; is that correct?

MR. PRIVEN: Correct.

COMMISSIONER JONES: Thank you. So a moment ago you mentioned that this is a little bit akin to the Price is Right. And, it is. I mean, the price has to be right because if it's not right we got a big problem on our hands. So what happens if you're wrong about the low end of your range? What if the insurance carriers set their pure premium at the low end of the range and you're wrong and it turns out to be your middle range estimate? That actually is where we end up in terms of the starting place for costs and the SB 863 cost savings? What happens if you're wrong in the system?

MR. PRIVEN: What happens to whom?

COMMISSIONER JONES: To the insurance carriers, let's start there.

MR. PRIVEN: So the insurance carrier -- the insurance carriers will likely lose money on the policies that they write if they write them at too low a cost.

COMMISSIONER JONES: Okay. And right now they're losing money on the policies they write; correct?

MR. PRIVEN: Probably, yes.

COMMISSIONER JONES: Well, didn't you testify earlier that the combined ratios are somewhere above 120 or 130 percent at this point?

MR. PRIVEN: Right. And I'll point out that those are projections, but in all probability, yes, they're losing -- they've loss on money on those.

COMMISSIONER JONES: Okay. But do you disagree with the projections?

MR. PRIVEN: No, I -- as I said, they probably are losing money, yes.

COMMISSIONER JONES: Okay. So then if you're wrong, they're losing money now and they're going to lose more money in the future; is that correct? If you're wrong about the low end of the range being the right pure premium benchmark?

MR. PRIVEN: If I'm wrong that the low end -- that cost --

COMMISSIONER JONES: Low end of your range?

MR. PRIVEN: Costs are higher?

COMMISSIONER JONES: Yes.

MR. PRIVEN: Correct.

COMMISSIONER JONES: Okay. Can they continue in business if they lose more money than they're losing now?

MR. PRIVEN: Well, that's a question for your Department to answer and largely depends on their surplus as well. Right? I mean, I can't answer that question.

COMMISSIONER JONES: I understand that. But given what you know about their surplus condition right now?

MR. PRIVEN: I can't answer that.

COMMISSIONER JONES: All right. Okay. All right. Thanks.

MR. CITKO: I have some follow-up. The information in your submission regarding Texas, it looks as though you've gone to the Texas Department of Insurance website and pulled out information. Whether these charts are in them or you took data from them and made these charts, I'm not sure. But I'm assuming since you're attributing them to the Department of Insurance in Texas, that those charts are from them?

MR. PRIVEN: Correct.

MR. CITKO: Yeah. But you also pointed out -- and I appreciate that you pointed out that IMR was just one part of the reforms that Texas instituted similar to what California has done at various times?

MR. PRIVEN: Correct.

MR. CITKO: So, I mean, IMR is one part but then you've listed, you know, five or six other parts of treatment guidelines, um, the instituting registration and training of doctors, uh, regarding the use of Medicare reimbursement structure; various things, and all those could have also effected medical treatment utilization and temporary disability.

MR. PRIVEN: It likely did affect it, yes.

MR. CITKO: Okay. But we don't -- but from the information you've been able to ascertain, there's nothing that tells us which part of those components really affected those decreases?

MR. PRIVEN: Yeah, that's correct. And I'll give a plug to the Rating Bureau. I mean, unlike the Rating Bureau cross-monitoring report which did break out the savings specifically by component as best possible, the reports that I was able to find from the Texas Department of Insurance did not break it out in that way. It would have made my life a lot easier if they had but they did not. You're correct.

MR. CITKO: Yeah, I think I misunderstood earlier because I thought maybe there was a study but actually there's been no study concerning it. It's just information from that Department of Insurance; is that correct?

MR. PRIVEN: I'm sorry?

MR. CITKO: There's no independent study? It's just what you looked at was information from the Texas Department of Insurance?

MR. PRIVEN: Um, I'd have to look back and see if it was done by the Department or if they commissioned it. I think you're right though. I think it was done by the Department.

MR. CITKO: Okay. And then you pointed out earlier that, you know, you don't know what their regulations say. You estimated it to be similar to what we're going to be but not really gone in and looked at their laws and their regulations to determine, you know, Are we comparing apples to apples or apples to oranges? Is that fair?

MR. PRIVEN: Well, we don't have our regulations yet, so I -- so I couldn't --

MR. CITKO: Right.

MR. PRIVEN: So I --

MR. CITKO: Right. So we're looking at their example but it could be entirely different based on the various components there and how they may affect the cost in their system versus California?

MR. PRIVEN: It could be different. I'll just say my understanding is that, you know, the intent is that it be similar and that it's the best we have. You know, there's no other -- there's no other state I could find at least that was a better example. So -- but what you say is correct. I mean, it could be different.

MR. CITKO: Okay. Thank you.
MR. DAHLQUIST: I think there's one follow-up here. You indicated a willingness to provide additional information --
MR. PRIVEN: Yeah.
MR. DAHLQUIST: -- as for the basis of your -- you know, pieces of your high end, low estimates. Can you do that and by when? Because I believe the record is scheduled to close at the end of 5:00 p.m. today.
Correct, Chris?
MR. CITKO: Yes, that's correct. Unless you need more time to get the information to us.
MR. PRIVEN: End of Monday would be great.
MR. CITKO: So we'll note that at the end of the record and we'll change it to 5 o'clock on that day.
One additional -- we were provided -- the Department was provided an analysis that was done by AON, A-O-N, which is a brokerage. Have you seen that analysis?
MR. PRIVEN: Um, I've seen a bulletin from AON, which, uh, a couple of pages talked about the reforms. I don't know if there's a more extensive analysis. I didn't see any exhibits backing up their numbers or -- I did see a couple -- like I said, an AON

bulletin which described the results. I don't know if there's a fuller study that I didn't see but I did see the bulletin, yes.

MR. CITKO: But according to their study, it seems like the impact is not as great in lessening costs to California Workers' Compensation system. Is that correct?

MR. PRIVEN: Can you repeat that?

MR. CITKO: The impact of these reforms is less than what you've predicted or even the Rating Bureau's predicted with regard to the cost? In other words, decreasing the cost of the system? I don't know. Do you recall the numbers?

MR. PRIVEN: I do. They, um -- they project for 2000 -- first of all, they don't -- as far as I saw, they don't say anything about 2013. Right? They only say -- talk about 2014 and subsequent. Um, they do conclude as I remember that there will be a net cost for 2014 and subsequent whereas myself and the Rating Bureau are projecting a net savings for 2014 and subsequent. They're silent on 2013 at least in what I saw.

MR. CITKO: But their projection is for higher -- higher cost for actually less of a decrease in the system? Actually, I think from what I'm looking at with that study -- and we've -- we'll put this study in the record too and I don't mean to put you in a position. If you haven't had a chance to look at it recently, I don't --

MR. PRIVEN: No, I've looked at it recently. You can ask me about it if you would like.

MR. CITKO: Oh, okay. But they're looking at -- through 2014 and on, they're looking at a 2.2 percent industry increase --

MR. PRIVEN: Right.

MR. CITKO: -- versus what you've estimated and what the Rating Bureau's estimated, which is a net decrease. So there are some actuarial analyses out there that are concerned that some of these reforms will not come out in a net savings to the system; is that right?

MR. PRIVEN: Correct. Are you asking for my comment about it or -- that's correct. What you're saying is correct?

MR. CITKO: If you want to make a comment, you're certainly welcome to. But I'm just looking at the numbers from this study. It's providing other information, difference of opinion than what you've provided and what the rating group's provided.

I guess the question I do have, is: When you saw this, did that have any effect on your opinion?

A. No.

Q. And why not?

A. Well, again, there was no data in what I saw. There may be a study out there that I haven't seen. But in the bulletin that I saw, there were no exhibits to go through as there is with the Rating Bureau or what I produced or whatever. There was no information provided that you could actually look at and see what their assumptions were.

From the verbal description of their assumptions, one of them was, for example, that eliminating Ogilvie would result in no savings at all. That appeared to me to be a biased opinion -- a biased point of view. Another --

MR. CITKO: And what was that biased?

MR. PRIVEN: Biased towards underestimating savings from the reforms.

MR. CITKO: In what way was that biased in underestimating the savings?

MR. PRIVEN: Because I believe most observers and participants in the system think that if the reform successfully eliminates Ogilvie cases, that will result in some savings. And by saying that there's no savings from Ogilvie, that's underestimating the savings.

MR. CITKO: But isn't that similar bias in their estimation of what will occur with Ogilvie cases as your estimation as to going to the lower end of your range?

MR. PRIVEN: I didn't go to the lower end of my range. I gave a range.

MR. CITKO: Yeah, but you -- from my understanding of your testimony here today is that if you were to pick somewhere on the range, that you would be at the lower end where public members and the governing committee is or am I misunderstanding?

MR. PRIVEN: I don't understand how they're similar. I mean, I have a middle estimate based on what can be quantified. And I outline that there's certain things that cannot be quantified that in my opinion will cause there to be greater savings, not greater costs. And so I think that if you just look at the middle of the range, it's biased high. I don't see how that's similar to saying there's no savings from Ogilvie.

MR. CITKO: So you're saying it's biased high. Therefore, you're concluding that you don't have a figure that you would recommend to the Department based on your analyses?

MR. PRIVEN: That's correct. I have a

reasonable range.

MS. REPORTER: I'm sorry. What was that?

MR. PRIVEN: That's correct. What I gave is a reasonable range.

MR. CITKO: And that's why you didn't give any probabilities to that so the selection could be anywhere in there including where the Rating Bureau actuarial committee was?

MR. PRIVEN: Correct.

MR. CITKO: Okay. Thank you.

COMMISSIONER JONES: Thanks, Mr. Priven.

MR. PRIVEN: Thank you.

COMMISSIONER JONES: Appreciate it very much. Thanks for your testimony.

So I think next we're going to hear from public members directly and I see Mr. Wick coming to the podium. Welcome Bruce.

MR. WICK: Thank you very much, Mr. Jones, Mr. Citko and Mr. Dahlquist. Could I reasonably anticipate you want to hear how I wrote it in the rationale?

COMMISSIONER JONES: I think I've seen the vote tally.

MR. WICK: So you want the rationale? I will give you kind of how that happened and then I'll give you the rationale for that. But what I would like to do first, if I could, Karyn Smithson-Hughes of Nestle Corp, the other public employer appointee, could not be here today. She did give some comments that I would like to share that are quotes from her. Karyn is a 34-year workers' comp claims person. She operates in multi states so she -- including Texas. So she has a good understanding of the challenges in California and the specifics of California.

What she said is: "I did want to state how excited the employers are on this new bill law. Everyone I talked to gets even more excited as we peel back more and more of this bill law meaning more understanding of it." And these are workers' comp claims people who are excited, which is not typically what they do. "The law shows --" I'm continuing to quote her "-- that someone has been listening to the employers and understands the challenges we face in the workers' comp process every day."

Another quote: "The new IMR process is huge to the employer."

And lastly, "The most daunting issue that has impacted the claims world is outstanding liens. I applaud the workers meaning of the writers of SB 863 because there was no end in sight to the liens. Now there is." And Karen voted in favor of the motion for 2.38.

So if I could just share kind of the process of what happened and then I'll share with you the rationale. I've been on the governing committee since 2008. Mark Priven came on in 2009. And when Mark came on, he started providing for us a range. Typically the Rating Bureau has a single number. Mark would provide again his low, middle and high range. And so when he started doing that, a very typical pure premium vote in the governing committee would be that, you know, Dave and the actuarial committee would put forth their number which was usually towards the higher end of Mark's range, an insurer member would motion that that number be accepted. It would be seconded by another insurer and then the eight insurers would vote for and the four public members would vote against, and then we would typically ask the Commissioner to consider a number in the middle of Mark's range which was usually 10 percent or so different than the Bureau's single number that was presented.

So going into this committee meeting that we're discussing, I had spent time reviewing Mark's numbers, his range, and the fact that this time as he stated his middle range could not -- as the Bureau said, their number could not yet account for savings from medical fees -- or fee schedules and those kind of things that just couldn't be actuarially quantified. So their number couldn't anticipate savings that were in the bill that we knew would take place but trying to put a number to it.

So looking at several different parts of Workers' Comp Rating Bureau information, my presumption was going in that an insurer would again recommend the 2.61, it would be seconded, and it would be an eight to four vote, and then we would promote to you a number but this time not Mark's middle number because clearly he said that couldn't contemplate the information in the savings. It could not be actuarially justified.

So my own thought -- and I'll get to the rationale in a minute -- was a number around 2.40 was perhaps more appropriate. And, um, when Mr. Row [ph.] made the motion for a lower number, the 2.38 number, my thought was, That's pretty close to my number and I thought about it for a little bit and decided to second that motion. There was a significant discussion about that as Mr. Mudge described. And at the end, the four public members did vote in support and one other insurer member voted and because of an absence, it was a six to five vote.

So in that sense, it wasn't for me doing something out of the ordinary. SB 863 has created out of the ordinary things for us to address. But the way this happened, I had never had an insurer motion in a governing committee meeting motion for a different number than the actuary presented by Dave Bellusci.

So I do want to share my rationale for that. I do agree with you, Commissioner, that these -- the reforms of SB 863 well comprehensive and sweeping, it's different than the '03, '04 reforms. So I did not anticipate that in a similarity here. I share your concern about insolvency. I saw what happened to employers with the severe number of insolvencies. So what happened to employees who couldn't get temporary disability checks; who while a company was being taken into conservatorship couldn't get medical treatment authorized? It was bad for both employers and employees. So I knew and I appreciate that you bring that concept up that we need to be aware of insolvencies and the solvency of the insurance industry in general.

So that is why I did spend time looking at -- and the year I took was 2010. It's recent numbers are -- you would expect that even cumulative trauma claims that can be filed after the policy year closes are probably mostly in, so they should have most of their claims. And so what makes up that 1.38 number? It doesn't include investment income, which for that year was 25 percent.

So we're looking at, as Mark Priven said, That's an ultimate potential cost that would be $1.13. But what's in that $1.13? There's the claims and reserves for claims that insurers have incurred. Insurers themselves put a 24. IVNR, a curve not reported, but primarily I believe we're looking at loss development. And the Rating Bureau itself adds another 18 points of IVNR above that.

And those things aren't wrong to do because part of this is understanding and I think it's part of why that there's -- you know, understanding Mark's view that without reform, things were potentially worse than the Rating Bureau numbers showed, but would reform work.

Our system was completely broken down. In nine years, hardly anything happened to help our workers' comp system. That's why SB 863 was so comprehensive and so sweeping and took so long for the negotiating committee to work their way through and I applaud their diligence to go through that. So you have IVNR numbers that are 42 points of the 1.13. Those numbers haven't been paid yet. Could they ultimately? It's possible. Loss adjustment expense also had gone up 18 points from

2004 from 9 to about 27. So of the 1.13 number, 60 cents of the number is what the reforms directly targeted, directly attacked trying to take that number down.

Now, you can't take it to zero because you'll always need an IVNR number. I really do hope we can get our loss adjustment expense back to 2004, 5 numbers. So how much of that 60 percent of the workers' comp dollar can this impact? I hope a lot. The benefit increases are about five percent and that's a very clear increase and absolutely employers -- those PD -- permanent disability benefit increases were negotiated clearly. The employers need to fully fund those. That's five points. So you got five points here and 60 points the reforms are trying to attack. We hope there are significant savings when that happens.

Another part that I look at to me and it impacts, Commissioner, what you're saying about the insolvency issue. That's kind of the -- the phenomenon is taking this year's whatever round numbers you want to take. Insurer's filed an average pure premium rate of 2.38 or average manual rate was in the range of 3.30-something but their averaged charge rate goes back almost exactly in the 2.40 range to what their pure premium rate is, which in effect would lead them as a charge rate, a pure premium rate less than $2, unless they're not paying their employees, or brokers, or re-insurers or taxes anymore, and I doubt that's taking place. So as you said at the start, this is an advisory rate and insurers are filing rates but they're charging rates that are nowhere near resulting in a pure premium rate that you're looking at.

So to me that -- and again, we look to the Department to say, you know, What does that really mean? And how do we in a sense monitor that insurers who have the freedom as you said not only to file rates but then to use their credit and so forth to come down to a particular rate?

So, with all that in mind, I did look at the range of Mr. Priven's. The low part of his range was 2.32. It has been expressed what his middle range is that could not account yet actuarially for systems savings we know will take place, and that's where I was thinking in the low range of 2.40. And when an insurer put out a 2.38, the largest, I believe, single insurer, Mr. Priven said someone who you would think would have some of their own statics, none were given out during the meeting, but they were an entity who did send a letter in the middle of the SB 863 showing that they had analyzed significantly what the issues are, and I would have thought he would have done some pretty significant analysis of his own.

So, that is why I landed where I was. Again, it was a surprise how that turned out but I presumed we were going to wind up with a workers' -- as is typical, with the 2.61 numbers and the public members would have come back to you with a number, but it wouldn't have been much different than what I voted on. And knowing that -- I appreciate, Commissioner, your concern for insolvency and I believe you tried to be balanced and thoughtful in taking all the information in. So that's the information I have to share.

COMMISSIONER JONES: That was very helpful. Can I just make one point about the State Compensation Insurance Fund which is the insurer that you noted made the motion? What's striking about this to me is that when you look at the State Compensation Insurance Fund base pure premium rate that is filed today, after you apply to it as a done, you see "m" factor [ph.], they're at $4.37. Now I know -- I know that there have been these public statements about that insurer filing a rate filing which will decrease their rates by, I guess, 5 percent. Um, but right now with regard to the existing market, they're at $4.37 and I'm eagerly awaiting that filing that will take them down to $2.38

for their book of business as pure premium. We haven't seen it yet.

So I appreciate the point you made and I appreciate your indication as to who made the motion and what weight that had in your decision-making. But I think it's important to note that in terms of their rate filing, we haven't seen a new rate filing that would comport with the motion that they made at the governing committee.

So I just want to point that out for everyone's benefit. But I really do appreciate your testimony. Thanks for walking us through your assessment and the process you used in coming up with your decision. I really appreciate it.

MR. WICK: Okay. Thank you.

COMMISSIONER JONES: Thanks, Mr. Wick.

MR. SMITH: Good afternoon now, Commissioner.

COMMISSIONER JONES: Good afternoon.

(Laughter)

MR. SMITH: Everybody. My name --

COMMISSIONER JONES: We didn't have lunch either, so. I apologize.

MR. SMITH: Yeah, I'm second to last between lunch and everybody -- everybody else and lunch else, right?

COMMISSIONER JONES: Yeah.

MR. SMITH: My name is Jeremy Smith. I represent the State Building and Construction Trades Council in my day job but I'm the other -- one of the other public members on the WCIRB. I was not going to go first. I was going to let my colleague from the Labor Federation go first, but I wanted to pick up on your last point, Commissioner. And I will say first that I've been on the board since spring so I am -- I jumped into the deep end of the pool in this world. I'm hoping that your actuary does not start asking me questions about what --

(Laughter)

COMMISSIONER JONES: I'm hoping he doesn't ask me any questions either.

MR. SMITH: Well good, I'm glad I'm not alone.

The State Compensation Insurance Fund, I've heard them described as the insurer of last resort. The point is, their book of business is largely construction and they have a much greater, uh -- I was trying to think of this word before I came up here.

Given that construction is such a business with lots of injuries, they're going to have a lot more exposure -- there's the word I was trying to think of -- to having to pay out claims. So I will just say that and then get back to my prepared comments which are very brief.

I will start with, I think, my thesis statement which is, Uncertainty should not automatically mean an increase in rates. I'm not the one writing the checks from the insurance companies for claims. I understand that. But I am the one who represents construction workers. And in the construction industry and in organized labor around construction, we work much more closely with our employers than other unions that aren't construction.

I hear from those employers who employ not only unionized construction workers but construction workers who aren't in unions that workers' comp is tough for them. It's expensive. It affects their bottom line greatly. Every employer has to have it in the state but construction employers I think are less likely to try and skirt around the law of workers' compensation given their exposure, given the workers that they employ. And they have to compete against -- they have to compete in the marketplace. And because of the fact that they have such high exposure as employers, you know, their profits are down which means that they can't employ workers. Not only again the ones that I represent but all construction workers.

As many people in the room probably know, every economic downturn that we've had and the one that we're in now, construction is always the last thing to come back. The broader economy always revitalizes itself quicker and then construction begins again at the end of these downturns. And that's happening now. And keeping a number like $2.38 per $100 of payroll or 2.40 which Bruce talked about, you know, coming from Mark Priven's study helps employers in the construction industry particularly get back -- get back to work, which means it helps the workers that I represent get back to work.

I want to associate myself with Mr. Wick's comments, what he laid out as to what happened that day is accurate. You know, we didn't talk to SCIF before we went there. We didn't know that was going to happen. But because it somewhat mirrored what Mark Priven had given us as public members in his study, we felt it made sense to move forward with a vote to have no increase.

I also wanted to say and in closing that while you mentioned you're waiting for SCIF to come to you to come back to the 2.38 number which, you know, true, I'm sure they won't. I think I explained as to why they can't. Nobody here today is talking about going below the 2.38 number or the 2.61 number if in six months or a year we find out that the reforms that can't be quantified bring in a gigantic windfall of money, none of us could even wrap our minds around today and even estimate.

So we aren't talking about -- you know, the insurers aren't talking about going down. I'm sure they could. As I said, I'm new to the board. So perhaps they could file in the next couple of years with you guys to lower rates -- the premiums -- the premium rates they charge. I don't think that will happen.

And I will -- now, I will finally end with this. I was in the room negotiating 863 with employers and other entities and we raised in those negotiations the stress on the insurance industry. We don't want them to go insolvent. We don't want them to not do business in California. Nobody wants that. But since the 2004 reforms, we felt in the room that workers, especially the permanently disabled workers, had suffered the most under those reforms and employers had borne the brunt of having to pay higher premiums since those reforms, which we felt like needed to be fixed.

And so, we did several things in the bill obviously to lower costs to the system for everybody. We feel like those things that can't be quantified right now today, understandably so in some cases, should be given time to go online so to speak, be in effect and then figure out in the next six months or a year how those things are affecting the system and whether or not we need to come back and have a higher per $100 of payroll number.

But as of today, we support what we did in the -- I support again still what we did in the board meeting that day -- the governing committee meeting that day and, um, thank you for the time to be here. I appreciate it.

COMMISSIONER JONES: Thank you. And thank for your service and Mr. Wick's service. And I just want to reiterate what I said at the opening. There's no question in my mind that SB 863 is a good thing. And I appreciate the Building and Construction Trades, and Labor Federation, and the employers that were involved in the negations. And one of the signatory benefits of -- no pun intended -- of the legislation is the ability to restore permanent disability payouts to what they should be because they were inadequate. And thankfully there are -- there seems to be widespread agreement that at the very least the SB 863 reforms have cost savings to not only cover the cost of those permanent disability payouts but some additional net savings.

The question is: How much more net savings to the system? And that's what we're grappling with here. Because if we are wrong -- and I understand on one side if we were wrong and there are additional savings and there is a pricing to reflect those additional savings, then there might be windfalls. But again, I think the legislature could have addressed that by adding a provision to claw those back, and I certainly advocated for such but there wasn't apparently appetite to do that.

But conversely, if we're wrong in the other direction, then we could have a real problem on our hands. And that's the central question that we're grappling with here and I really appreciate your thoughtfulness and the other witness' thoughtfulness in trying to assist us in figuring that out.

MR. SMITH: May I just say one thing?

COMMISSIONER JONES: Absolutely, yeah.

MR. SMITH: We've gotten with that also in all those meetings, both in the short six-hour meetings we had and the long 15-hour meetings we had on negotiating this bill. It was impossible. And I think you'll harken back to your time in the legislature for us to put any kind of language in that bill that would have limited what the insurance companies could make. The businesses that were in that room, uh, are part of the larger chamber of commerce world of businesses and they had to answer -- go back and answer for the negotiations that they did.

So putting something in that bill like that, I -- in my ten years as a lobbyist, I don't think that -- that would have killed the bill. So I'm not trying to be argumentative with you --

COMMISSIONER JONES: No.

MR. SMITH: -- I think, though, that that could be something that we could look at in the future; however, when you have a governor and you have a legislature that wants to balance the needs of labor and balance the needs of business, something like that is almost impossible to put into a bill.

COMMISSIONER JONES: My point is only that I -- I am statutorily directed to consider certain things in this process. And if the legislature had enabled me to consider other things, that would be wonderful and I wished I had that authority but I don't.

MR. SMITH: I understand.

COMMISSIONER JONES: So I'm -- I'm -- I've got to stay within the guardrails of this process and that's -- that's where I am. Thank you.

MR. SMITH: Thank you.

COMMISSIONER JONES: Thanks a lot.

MR. SEAMAN: Thank you Commissioner Jones, and Mr. Dahlquist, and Mr. Citko. Mitch Seaman with the California Labor Federation. There's not a whole lot left to say. I would just echo the comments of the other public members and our actuary.

In -- briefly mentioning how the 863 negotiations happened and sort of what brought the worker representatives to the table, when we began the process of negotiating the bill, our main focus was basically twofold. We wanted to help address the permanent disability benefit issue while also dealing with delays and the costs associated with those delays. Primarily in the amount of time that it takes workers to receive needed medical treatment for injuries sustained on the job and the dramatically increasing costs associated with that and the long-term effects that that might have on overall system solvency.

And as we began in negotiations as Jeremy mentioned some of which stretched the 14, 15-hour long meetings, the more and more surprised we were at the amount of common ground that there was between us and the employers across the table that every dollar that they're spending on insurance premiums is a dollar that doesn't go to our wages, it doesn't go to benefits, it doesn't go to an increase -- or an improvement in working conditions that the employer can't use to invest and grow their own business; that there was intense pressure on all of us to find ways to reduce those costs while getting workers the treatment that they needed sooner.

And the bill that we eventually arrived at and were able to pass through the legislature, we were blown away by all of the components in there that did exactly that; that did reduce costs; that did get workers treatment faster. But there was sort of hanging over all of that the realization that most of that couldn't be quantified.

But going back in my head through all those conversations, other than the discussion around the permanent disability benefit increases, I remember the vast, vast majority of all of those components of the bill reducing costs. And many of them in ways that couldn't be quantified and will never be quantified. But that overall, we were driven by this constant force of making the system work better, faster, cheaper even if it wasn't going to translate into a dollar amount at the end of the day.

And so when the bill passed, we couldn't have been more excited with the text of it and all the savings that were achieved within it. And I think that's what drove at least my motivation in supporting the motion to not increase the pure premium rate at this filing at the last governing committee meeting was that just hours and hours of going through that bill and listing out all the different ways that the savings were going to be achieved through IMRs, was mentioning the fee schedules, conflicts of interest; all sorts of different areas of that bill from start to finish that were going to reduce costs but that weren't going to wind up in any kind of a -- in any kind of a dollar amount that could be pointed toward.

But that we had to find some sort of way of translating that into the original goal of the bill which was either more money available for wages, benefits and improved working conditions, or more money available for an employer to use to invest and grow their own business rather than just being lost in all these different elements of the system, these wasteful delays throughout the system.

So that really drove our support for that motion and I think the fact that it is, we believe, very much actuarially defensible as was mentioned earlier. It just further emphasizes how important it was for us to find some way of achieving those savings and realizing those savings that were in the bill. And we feel that we -- we feel that they have been realized as much as possible but that, um -- but that the motion made sense. And we voted for it and hopefully -- hopefully something similar to it stands. So that's all I've got. I'd be happy to answer any questions.

COMMISSIONER JONES: Thank you very much. And again, I appreciate Cal Labor Federation's leadership in accomplishing SB 863. It's a good thing.

MR. SEAMAN: Thank you.

COMMISSIONER JONES: Thanks.

Okay. I just want to make sure there aren't any other public members who wish to testify at this time. I think what I would like to do now is invite -- because we've had a lot of numbers thrown out and there are a lot of differences in what is being suggested as the pure premium benchmark. I'd like to invite one of the Department's actuaries just to walk us through briefly just to make sure we're all on the same page with regard to what's really before us at this point. So with that, let me turn it over to Gio.

And just to be clear, then after this we'll open it up to anybody else who wishes to testify. So those of you who have been waiting patiently that haven't had a chance to testify yet, you'll have an opportunity to do so.

MR. MUZZARELLI: You guys are going to be nice to me, right?

MR. CITKO: We will.

COMMISSIONER JONES: We're nice to everybody.

MR. CITKO: If you could give us your name even though we all know you up here.

MR. MUZZARELLI: Giovanni Muzzarelli, senior casualty actuary with the CDI.

COMMISSIONER JONES: It's a good Scotch name.

(Laughter)

MR. MUZZARELLI: Good Scotch name.

Thank you. Again, just wanted to put together here a review, a brief summary, of the major issues and some of the various numbers that have been put forth today. High level commentary: Again, the industry filed pure premium rate of 2.38 was what was in place as of 7/1/12. Industry filed pure premium rates have increased to 2.49 reflecting the filings made subsequent to that. And that represents about 52 percent of the GPW of market and is about 64 of the top 120 companies have made those filings.

MR. CITKO: G-P-W?

MR. MUZZARELLI: Oh, gross premiums written.

MR. CITKO: Thank you.

MR. MUZZARELLI: SB 863, again provides appropriate increase in the PD rates to the injured employees with significant decreases to the system costs which more than offset the PD increase.

And then lastly again, underlying all this is that the premium rates apart from SB 863 continue to show upward cost pressure with adverse development noted by Mr. Bellusci for the recent accident years for medical and indemnity.

And then we can go to the second slide.

MS. REPORTER: Can you slow down just a little bit?

MR. MUZZARELLI: Yes, I will.

MS. REPORTER: Thank you.

MR. MUZZARELLI: And again, this is a slide that puts up some of the numbers that we have previously discussed. On the far left column is the 2.73, that is the WCIRB's actuarial indication ex/SB 863.

COMMISSIONER JONES: What does "ex /863" mean?

MR. MUZZARELLI: That means that we have not reflected any net savings from Senate Bill 863 yet. So that would be the actuarial indication before we overlay the PD increases and corresponding off-setting system savings.

For 2013 effective year, the PD increases would increase that 2.73 to 2.82 and then the -- and again, that's the WCIRB estimation. And then the resulting savings of 1.5 billion dollars as computed by the actuarial committee process would reduce the 2.82 to 2.61, and that was the final actuarial indication from the WCIRB.

It was noted before 2.38 is the WCIRB's actual filed pure premium. And that implies an additional $1.6 billion on top of the $1.5 billion noted above.

Again, there might be some slight differences between the numbers that have been discussed earlier largely due to the fact that in this case I'm using the $19 billion total system loss basis and Mark Priven for example might have used a slightly smaller number. So the dollar figures might be a little bit different.

In addition to that, I just want to note again that the changes in the industry average of filed figures, the 2.38 which was the basis for the governing committee's filing would note that filings as of last Friday, I believe, reflected 2.49. Again, that's 52 percent of the marketplace. If we actually extrapolate to the rest of the private marketplace, the 2.49 would become a 2.57. If we set aside SCIF's 13 percent of the market and go from 52 percent of the market to 85, that to 87 percent of the market, and assume a similar rate increase as has been made by the first 52 percent of the market, this would extrapolate to 2.57 just for informational direction and indication.

MR. CITKO: And those are pure premium rates?

MR. MUZZARELLI: Yes, yes, these are pure premium rates.

MR. CITKO: Okay. Thank you.

MR. MUZZARELLI: We actually have one additional slide. Okay. Again, just few additional figures to put forth. The left-hand set of the column is for WCIRB actuarial indication we just talked about. Uh, Mark Priven's Bickmore midpoint figures are in the middle set of columns. And I believe Commissioner referenced the 2.87 figure as pre-SB 863 midpoint estimate from Mr. Priven, which would compare to the 2.73 pre-SB 863 central estimate from the actuary -- WCIRB actuarial committee.

Mark -- Mr. Priven's figures increased at 2.95 with his assessment of the -- of the PD increases and then the decrease stamp to 2.61 reflects the larger assessment of savings from SB 863 which he had computed. Using a similar base of $19 billion for system costs, Bickmore's midpoint savings equate to about $2.2 billion as compared to the $1.6 billion -- or excuse me -- $1.5

billion corresponding to the WCIRB's actuarial indication.

And then lastly, it was noted that AON, a brokerage, had put forth a newsletter to their clients in October of their opinion of both the PD increases and the system savings from their perspective. And they assume a larger PD increase than what has been reflected by the WCIRB's actuarial committee as noted in their document due to their belief that utilization is going to be greater. They use the term non-linear relationship that because the TD benefits -- PD benefits are increasing, there's going to be a greater -- greater effect than what has been reflected in the WCIRB's figures.

They also share a concern that the savings -- the system savings are going to be somewhat less, approximately 50 percent that of the WCIRB's actuarial indication. And as Mr. Priven noted, they don't have detailed documentation in their write-up, they do put forth some bullet points as to why they believe that to be the case. And the important point here is recognizing the probability that things don't work out as all the participants hope that they will, and I think that may be what AON is reflecting is that there is some probability that the system does not react in the most favorable manner that we are -- that has been anticipated in the language of the reforms.

And what these figures here represent, is the net effect from AON assuming the same starting point as the WCIRB actuarially indication. 2.73 is the same starting point. They've got a bigger PD impact, a smaller savings impact, and their net effect is a positive figure. And again, that's -- that's an additional third parties perspective.

COMMISSIONER JONES: Okay. Great. That's very helpful because I begin to get a little lost in all the numbers. We seem to need a taller podium for you.

MR. MUZZARELLI: Yeah, shorter legs.

COMMISSIONER JONES: Yeah. Okay. Thank you very much.

MR. MUZZARELLI: Sure.

COMMISSIONER JONES: So why don't we turn now to any other members of the public and I appreciate your patience and see if there are any other members of the public who wish to testify at this point in time. We have a list. Maybe what we'll do just to do this in a -- do you want me to just call them out by name or do you want --

MR. CITKO: Well, we have Mr. Sektnan I see you standing up ready to go. You're on the list if you would like to speak at this time.

(Brief discussion)

COMMISSIONER JONES: So anybody who is going to speak, please give the court reporter your business card so she can have your contact information, that would be wonderful. You don't have to provide it right at this instant but maybe at the end of the proceeding would be fine too.

MS. REPORTER: Thank you.

MR. CITKO: Thanks, Mr. Sektnan.

MR. SEKTNAN: Mark Sektnan with the Association of California Insurance Companies. I know you've all heard a lot, and like you I'm completely lost of the various actuarial assumptions. So I'll try not to spend too much time on it except to acknowledge that right now California faces a major crossroads in the worker's compensation market. The legislature as we've discussed over the last several hours has passed major reform, but as has often happened in the past both in 1993 and 2002-2004, we spent a lot of time trying to determine what the reform actually does.

And we also have a problem because, quite often the reforms are based on regulations or changes in practice that we don't know if they will actually occur.

I happened to have been involved in the 899 development and I know there were lots of the things in 899 that we drafted that sounded like a good idea that turned out not to work anywhere near the way we expected them to do.

I'll give you an example. One of the issues, of course, bump up, bump down the 15 percent up and down, we thought was a great idea to try and encourage employers to bring workers back to work. We didn't realize this and we put in the one-year rule. We excluded most construction, entertainment and other temporary employers. We didn't think about that. We were worried about employers using it as a management tool to get rid of employees and still use the 15 percent. That's been taken out here because it clearly didn't work.

We are operating on an assumption based on regulations that have -- we have not only not seen yet but haven't actually been released. As an example, one of the regulations that has been released is the spinal surgery. That's a small cost savings anticipated in all the various reviews. The first set of regulations, if you looked at them and then you looked at the second set of regulations that just went out for a 15-day review, you will notice that the savings already within that single set of regulations already, I believe, needs to be decreased. Because the surgery centers and the hospitals who were concerned about spinal surgeries were able to get changes in the regulations that we think will drive up costs.

Independent medical review. Now, I have to say I'm a big fan of independent medical review. I was advocating it in 2002 when Jackie Speier was thinking about it. So I'm a big fan. The challenges we don't truly understand exactly how it's going to apply in a workers' comp setting.

In group health -- and I helped draft a bill that set up in group health. It's very clear. We don't fully understand in workers' comp. Does it apply to all medical decisions? When you talk to some our folks, they'll say, It's going to have very little impact because very few disputes are based strictly on medical decision, treatment decisions. But when you talk to other people -- we had a meeting on Wednesday -- they're talking about there possibly being 100,000 cases that will be submitted to the enrollment contractor, who is MAXIMUS. MAXIMUS currently handles around 2,000 cases for the Department of Managed Health Care. How are they going to deal with going from 2,000 to 100,000? But there was use of the word today the range of cases that are possible are amazing.

Liens is another example. During the legislative process the three groups that you've talked about; the Rating Bureau, Bickmore and State Fund provided cost savings estimates throughout the process. One of the elements that we had a huge concern was, was the projected lien savings particularly those by the State Fund. And one of the reasons you might have seen much larger liens savings attributed to State Fund is probably because they have a much larger percentage of liens in the marketplace. I have some companies that don't have any liens. So the liens savings inherently here will not apply to those people at all.

We also, of course -- and I talked a little bit about it. We also have a lot of unintended consequences. There has yet to be a workers' comp bill that has been drafted that has worked anywhere near the way we anticipated it would be. If you go back to the 1993 reforms when we developed the treating physician's presumption, everybody felt it was a great idea. By 1996, as the courts expanded with the treating physician's presumptions stand stood for, you then saw the industry completely collapse as you mentioned a little bit earlier in 1999 and the year 2000.

You have spent and your office has spent a lot of time with this pure premium advisory rate both to explain what it is and is not. It is not a rate setting obligation. It is an advisory rate. And also, to take it away from where we saw with the last commissioner where many of the decisions were made based on political determinations and his desire and belief -- expressed desire to keep rates down as if he actually had that authority and the data that was coming in not only from the Rating Bureau but also from your own staff. We went through three periods where there was absolutely no increase and that led to a situation that we have now where we're kind of influx.

And we really do appreciate your efforts and your staff's efforts to reenergize and reinvigorate this particular process because we think it's an important process. It's an important process for us to get a snapshot on what is going on in the workers' comp industry, not only for employers and policyholders, but also for policymakers. And so it's very important we keep this as closely to it as we can.

There has been some talk about solvency. That is an issue. Quite frankly, that was an issue we saw coming up. You know what the loss ratios are. You know, in 2002, 2003, they were over 160 percent. Some carriers were high as 175. That partially was part of the impetus for some of the reforms and a lot of the decrease or as Mark Priven refers to it as windfall, actually went into rebuilding reserves and a lot of the insurers needed it after that time period.

Right now you see the ratio at 138. One of the reasons for this bill was to deal with the stress in the insurance industry so we can maintain a healthy marketplace.

I don't know where Mr. Wick gets his 25 percent investment income. My 401(k) certainly hasn't seen that. You as the regulator know that most investments by insurance companies by both your rules and the MIC rules have to be in low-end bonds, highly secure, highly liquid, that pay next to nothing. But then again, we need to keep adequate rates and a perception that rates are going to be adequate, helps us because it helps provide for a healthy marketplace. You know, if you look at AON and you look at some other stuff, these are the tools that insurers look at as to whether or not (a) they want to expand in California or in some cases enter into California.

Remember, the capital gain here in the United States is not just for California but it's for other states that might have better markets or for other countries that might have better markets. So we want to maintain a active healthy market here in California which is the best thing for employers. We need to make sure the rates are adequate.

Another thing, during the entire legislative process when we had meetings with Christine Baker, on a number of occasions we had meetings with the governor's office, the message we kept doing -- they kept saying is, This will not result in rate cuts. It was not designed to do rate cuts. As Christine Baker once said is, It will moderate that the rate increases because we already had a system that was already stressed out.

So we ask you to, as you're doing here, take a hard look at the actuarial numbers and try and rely on the data that's been provided to you.

Thank you.

COMMISSIONER JONES: Just a question Mr. Sektnan. I appreciate your testimony. One of the things that I mentioned earlier that is troubling to me is that when the governing committee made its decision, it had in front of it the filed average pure premium rates as of July 1st, 2012, even though it was making his decision in late December, early October. And as we know now, the filed average pure premium rate is 2.49 which reflects admittedly not all of the market, something on the order of 52 percent of the market, but our actuaries have done an extrapolation assuming that the trend of filing continues as it has and that takes us to potentially $2.57 average filed pure premium benchmark.

So the question is this: The market does not appear to be responding in quite the way one would predict. It should respond, given some of the assertions that have been made by public members and Mr. Priven and others with regard to the cost savings they project from SB 863. And to be very, very blunt, I'm interested in what your response is to what I think would be their question were they able to ask you the question, and that is, you know, What confidence do we have even if -- even if -- as they -- as they assert -- and you can question those assertions and you can question the actuarial basis for those assertions. But what confidence should we have that if the additional savings that Mr. Priven and the public members are asserting will accrue, do accrue, that that will actually be reflected in the filings of insurance carriers?

Their argument is essentially, We're going to do all these savings, but the carriers will be positioned to continue to increase rates as they see fit to garner substantial increase returns, and that the savings will mirror principally to their -- some component of the net savings will mirror principally to their advantage, not to employers and not to injured workers. So it's a long question but I think you get the gist of it. So what response do you make to that?

MR. SEKTNAN: My opinion is my opinion only because I can't speak for the industry because quite frankly we're not nearly as organized as people think we are.

I think if you look at the rates that came out of the 2003, 2004 reforms where you were dealing with, I believe, like $6.25 and now you're down to 2.30, I would suggest that most of the savings have been passed on. I think when you look at the adjusted loss in the combined ratios where we're actually paying out $1.38 for every dollar that we're bringing in, which to me it's not really a long-term business strategy that's going to be successful, I would suggest that we could possibly be passing on labor savings -- all the savings that we've seen on SB 899, but indeed, more savings than we're actually inheriting in 869 -- or 899. This is going to be a challenge having two SBs both in the 800s.

But I think as long as we work to maintain a competitive marketplace and a healthy marketplace, I think the market will take care of that. There are a number of different companies in here. As long as we can keep the number of companies here -- and in fact, maybe even encourage additional companies in here. There are always companies that are willing to move into a state that they think they can make a good investment in and they will often drive prices down. That's what we saw after the imposition of the Minimum Right law and now of course for reasons that we could probably spend another hour on, it didn't work so well for a lot of companies.

We saw a lot of new carriers come in after 2000-2004 that brought the rate down. And I would anticipate that once carriers become comfortable with what really is in this bill -- I mean, it's nice for us to hope we know what's in this bill, but actually what is in the bill and how it actually operates in the real world, I think they'll come in. Because, you know, we also have to pay attention a little bit to the three rules of workers' comp, which is, the bill never works out the way you thought it would, the courts interpret it in ways you never thought imaginable, and some entrepreneur will figure out a loop hole that you never even dreamed of, and it's happened every single time and it will happen here.

COMMISSIONER JONES: Okay. Very good. That's very helpful. Thank you.

So others who have indicated they would like to testify, or even if you didn't so indicate, why don't you come forward now and tell us your name and your affiliation.

Welcome.

MR. MARKUSON: Good afternoon, Commissioner Jones. I'm Richard Markuson with Pacific Advocacy Group. I'm here representing the plumbing, heating and cooling contractors of California and the Air-Conditioning Trade Association; two of the construction industry groups that are supportive of keeping the advisory rate where it has been proposed. But we are also a little bit concerned about the changes that are being proposed for the threshold for the dual rate.

On that note, it specifically affects smaller contractors and residential contractors, and as concerned as we are about keeping solvency within the insurance industry and keeping a vibrant workers' compensation industry available to sell the product in California, we're also very concerned about the solvency of small contractors. Unfortunately, we haven't had an opportunity to completely quantify what the impact would be with those changes. However, we are concerned that it will have an impact and could throttle back the rather modest recovery that we're seeing in home construction right now.

Thank you for the time to address you, sir.

COMMISSIONER JONES: Can you share with us -- so you're talking about a particular change in classification or other the rule associated with the --

MR. MARKUSON: We're concerned for plumbers and for sheet metal. Our concern is that by raising that threshold for the lower premium rate, a smaller contractor's -- contractors who are working primarily in the home construction area who are paying the lower average hourly rate in that range between the 24 and what is being proposed for 29 for the threshold are going to have additional premiums that will be associated with that change in the threshold and that's going to effect their bottom line.

COMMISSIONER JONES: Do you recall the specific class or classification that we're talking about?

MR. MARKUSON: It's the two classifications that are in the handout. One for plumbing and one for sheet metal.

COMMISSIONER JONES: Okay. And then what would you advocate we do in lieu of that?

MR. MARKUSON: It's -- that's a difficult question and I'm certainly not an expert in workers' compensation. And I -- I understand that it is a -- a complex issue. And our bottom line concern is that by changing those thresholds, that there will be kind of a bottom line impact on the contractors who are paying in that range and would be seeing a workers' compensation premium increase for someone, say, who's taking advantage of the lower rate at $25 or $26 an hour, now they're going to be paying a higher rate until they get up to the 29 or 20 -- whatever's being proposed for the change.

COMMISSIONER JONES: Okay. And then, maybe we can hear from the WCIRB on that particular item if we could because I don't know that we got any testimony specifically from the WCIRB on why they're recommending that particular classification change. And if there isn't someone here to provide that, then maybe I think we're going to keep the record open until ...

MR. CITKO: Until 5 o'clock on Monday.

COMMISSIONER JONES: On Monday. And so if we could get a further articulation from the WCIRB as to that particular one, that would be useful.

Is there someone here who can speak to that now?

MR. BELLUSCI: There is.

COMMISSIONER JONES: Great.

MR. CITKO: I do have one question before you leave --

MR. MARKUSON: Sure.

MR. CITKO: -- before you leave. And the dual wage is something that we have struggled with in dealing with these rule changes for so long. My understanding is that the Rating Bureau -- and they'll talk to this or speak to this, will be -- you know, they've done studies on inflation and what has occurred out there, and that what they're trying to reflect is even though the economy has been down, that there are -- there is still wage inflation that is occurring. They're just trying to reflect that to keep things balanced.

In other words, what may happen is that, you know, as wages rise we have a situation where more employers are going into the lower rate and it's not truly reflective of the loss that's occurring based on where that division of the wages is because of the inflation. Is that you're understanding also?

MR. MARKUSON: Well, and certainly there has been wage inflation or wage increases, but we've seen those primarily in the prevailing wage classifications.

And we've actually seen some wage deflation in home construction. Some crafts right now are -- I guess you would say they're weathering 40 percent unemployment, and in those cases where there's significant oversupply of workers. We've actually seen some wage deflation primarily in residential construction.

And so, the push certainly has been -- or the increases have certainly been on the higher ends of the income and primarily in prevailing wage. We haven't seen the same kind of pressure in light commercial and also in residential.

MR. CITKO: And that's exactly what I was -- you've answered my next questions. I wanted to see -- or ask you what you've seen in the industry, and thank you for that.

MR. MARKUSON: You bet.

COMMISSIONER JONES: But are the crafts doing the residential home construction? I thought that most of the crafts were not any longer doing residential home construction.

MR. MARKUSON: Oh, absolutely. Residential -- I mean, the 25 or so thousand housing units that we'll build our next year in California are down from a high of about 250,000. There are still -- although there are general contractors who will typically do the carpentry and maybe a couple of other associated tasks along with that; particularly, for electric, for plumbing, and for HVAC, those are being performed by subcontractors who are the specialty contractors under the Contractors State Licensing Board.

COMMISSIONER JONES: Okay. And you're here on behalf of the --

MR. MARKUSON: Of the heating and --

COMMISSIONER JONES: -- heating and air-conditioning contractors --

MR. MARKUSON: Heating and air and plumbing.

COMMISSIONER JONES: And plumbing contractors. Okay.

MR. MARKUSON: Thank you.

COMMISSIONER JONES: Thank you very much.

So let me give Mr. Bellusci a chance to respond then too.

MR. BELLUSCI: Yes, I'll just give you kind of a general background of the process, and if there's more information we'll provide it before the record closes on Monday.

MR. CITKO: Well, let me just ask you before you begin. You did provide to us the studies that you've done that support these changes. I know that you've been working --

MR. BELLUSCI: Oh, did we provide those studies?

MS. MARSH: Yes.

MR. BELLUSCI: Yes, I guess they are already in the record.

MR. CITKO: Okay. All right. We'll review -- we are reviewing those and we'll look at them again in light of this testimony.

MR. BELLUSCI: Essentially, uh -- without going too much into the history, you know, California has a system, it's kind of unique, where for 18 construction classifications, they're segregated into two based on hourly wages paid to their employees. The idea being is that the losses per hundred dollars of payroll are much -- have historically been significantly higher at low wage paying employers than they were for high wage paying employers. So to increase the fairness of the system, basically there's two classifications and split at a particular point which is the threshold of the issue that was raised by the gentleman.

And so for each classification, there's a threshold that's established at a level that the goal being is, you know, you have significant wage loss differential between those below the threshold and those above the threshold. You have relatively few employees right at the threshold because you don't want big shifts for small changes and wages and that -- and both sides are -- they're fairly large so you could come up with a credible rate. You have a big enough group below the threshold and a big enough group below [sic] the threshold, so in both cases you could develop a credible pure premium rate.

So that's sort of the basis. These have been in place for the initial classes back in the late '80s in California. So, um, for a time -- and I'm thinking it was roughly four years, you know, there had been no dual-wage threshold. Some of the -- some of the concerns -- we all know the rescission hit construction particularly heavy. It didn't hit all construction the same or at the same level and at the same time period, so for a period of around four or five years, there hadn't been any increases in the dual-wage threshold.

So in the last two years what we've been undertaking was a number of studies related to the dual-wage threshold. One of which was, should we continue it and we're recommending, yes, it does work better than the alternatives we looked at. But then secondly, we're in the process of conducting a series of surveys where our staff goes out and interview individual employers in each of these class and get a distribution of how their wages are being -- what wages they're paying to their workers in these classifications and then matching them up with loss histories to see that we have the right thresholds in place.

And so what was represented in the filing for this year was a series of changes for 11 or so of these construction classifications that were based on this most recent survey information. Again, the idea of getting the best threshold for that classification that most appropriately segregates it into the two pieces. And by best, we were looking for, again, those three or four criteria big enough, uh, not too many employees right at the threshold level and then that you had a very significant differential and loss experience between those employers with average wages below the threshold and those employers with average wages above the threshold. And those recommendations that were part of our filing submitted in August reflect those studies.

COMMISSIONER JONES: So if I under that correctly, so you're proposing then based on those surveys and studies of what's happening in these various submarkets to raise the threshold in some cases, I guess in this particular case, for plumbing contractors and for sheet metal and air-conditioning contractors, and then in effect of that will be that there will be more of their employees that will fall below the threshold and potentially be classified in a way that would result in a higher payment of workers' compensation premium than less employees above the threshold. Because you're moving the threshold up? Do I have it right?

MR. BELLUSCI: For the classifications -- there was some that we didn't propose changes. But yes, for those classifications --

COMMISSIONER JONES: For these two, it sounds like what the prior speaker was concerned about is the threshold's going up.

MR. BELLUSCI: Yes. And part of that is, in an inflationary world, uh, if you don't, ultimately everybody ends up in the high wage class anyway. So to keep over the long term, there needs to be increases to kind of keep in that threshold because as wages move up, you need to keep -- the thresholds need to change to kind of keep the program viable.

So to some extent -- to some extent it's a reflection of the inflation that's happened in the four or five years since we've last increased it and some of it's based on what, you know, what we saw in the individual classification.

COMMISSIONER JONES: But the assertion was made a moment ago that in the context, I guess, of -- now, I'm paraphrasing. But commercial work where prevailing wage would apply, there has been inflation but in the light commercial and residential area where prevailing wage doesn't apply, there's been deflation in wages. I'm just curious what response you would make to that to what was testified to a moment ago in terms of what impact that might have on your thinking about the threshold.

MR. BELLUSCI: Well, that's not a segregation we've looked at in these classifications. What we have looked at besides the surveying of employers in these classifications which presumably would represent some in the residential area and some in the more prevailing wages, we do look at some measures of inflation by industry that the State publishes and those tend to often again also be at a trade level and not have the differentiation between -- you know, segment any particular trade between more residential and the more prevailing wage type of work. So we've not really looked at that issue and that kind of differentiation between that segmentation.

COMMISSIONER JONES: So as far as you know, you didn't just survey the heating and air-conditioning contractors and plumbing contractors that are doing commercial work where the prevailing wage might apply and leave out of the survey those that -- and I don't even know if the industry divides itself this way. I'm guessing they probably have a share of all of it, but I don't know.

But you didn't leave out of the survey surveying with regard to what's happening on the residential and light commercial side as far as you know?

MR. BELLUSCI: No, we did not. Our survey was based on a random sample of all employers in those classification that reported payroll within that classification. So there's no reason that we didn't have a representation of both of those segments that's roughly proportionate to their representation in the California market.

COMMISSIONER JONES: Okay. All right. Thank you. It's helpful in understanding.

MR. CITKO: All right. Do we have anyone else that would care to provide public comment?

(No verbal response)

MR. CITKO: Okay. Seeing that we have no others, if you would like, any closing comments, Commissioner?

COMMISSIONER JONES: Well, I just want to make sure. So there are really two items we're hearing here. One is the pure premium benchmark, but the second is, is what we just got into a little bit a moment ago, the issue of the, uh -- the issue of the classifications and other rules associated with establishing the pure premium benchmark rates across classes.

So I just want to make sure that the public is aware of that and there's an opportunity to testify on both and that nobody is here that wants to testify on the latter of those two that didn't have a chance to do so.

(No verbal response)

COMMISSIONER JONES: Okay. We've worn you down. So I just have a few -- I promise -- closing remarks.

So as I said when I opened the hearing, my responsibility is to evaluate the pure premium rate filing by the Workers' Compensation Insurance Rating Bureau to determine if it's reasonable, well-supported, and adequately reflects the costs for the next workers' compensation insurance policy period.

That decision is an important one. I think one of the witnesses referred to it as the Price is Right, and I couldn't think of a more apt metaphor. Because if we don't get it right, that could have very significant consequences for the solvency and viability for workers' compensation insurance carriers, and in turn for the availability of the product in the market, and in turn for the pricing of product in the market which has potentially significant consequences for employers and their ability to hire more employees.

And I did spend time in my opening remarks, I won't dwell on it, with regard to what happened in the late '90s, early 2000s here when the price wasn't right and the market collapsed.

So we've heard testimony today that there is a stark difference between the actuarially indicated rate that was calculated based on the Workers' Compensation Insurance Rating Bureaus actuarial committee and the rate that the Workers' Compensation Insurance Rating Bureau governing committee recommends. That is a concern to me and we've taken a lot of evidence on the process, what was considered, what wasn't considered.

As I alluded to, one concern I had is that the governing committee in making that decision did not have in front of it an up-to-date data point with regard to the actual filed pure premium rates as of the date that they were making their recommendation. They were relying on a filed average pure premium rate as of July 1st, 2012, not as of late September when they made their decision and that's a concern to me because it does strike me that to some extent what the governing committee did was just default to what the filed average pure premium rate was or what they thought it was, which was -- which was in fact not what it was because they didn't have updated filed average pure premium rate information before them. So that is a -- that is a concern to me.

I'm also concerned about the actuarial basis for the decision that the committee made.

And I wanted to stress something I've said throughout the hearing, and that is, I agree and I think there's seems to be unanimity of opinion that SB 863 is a good thing. In fact, prior to the enactment of SB 863 I testified before a joint legislative committee of the legislature and testified that costs were increasing in the workers' compensation insurance system, the combined ratios exceeded premiums by a significant amount, and insurers were paying out more than they were collecting in premiums, and that ultimately this was not sustainable in the long run.

And I said, Action is need to address these increases and thankfully -- thanks to the leadership of the California Labor Federation, the Building and Construction Trades, employers and others, they blazed a path and came up with a very significant and thoughtful series of reforms and that not only allow us to make sure that we're dealing with permanently injured workers in a more adequate way, but also provide for cost savings to offset those permanent disability payouts and net additional cost savings.

But herein lies the question that's before us: How big are those additional net cost savings? And that is a question that we're going to have to decide in issuing a pure premium advisory rate filing.

Now, I also want to underscore that we're most appreciative of the governor, and his staff, and his leaders at the Division of Industrial Relations as they're working on regulations to implement SB 863. And I've talked to the director. I've talked to the governor's senior staff. We're offering assistance, technical advice and support in whatever way they deem helpful because we have a common goal. I think all of us in this system; employees, employers, insurers, the public sector, all have a common goal in getting these regulations done, making sure they're robust, and making sure that they effectuate the goals of the legislature, the governor and all the stakeholders in enacting SB

863. So we will continue to work closely with the Brown administration to do precisely that.

I also do appreciate the WCIRB's thoughtful comments and others comments as well as with regard to the importance of monitoring the implementation of this. I know that we're going to have to watch that closely and I expect to hear from the WCIRB as they're doing monitoring with regard to what they are seeing as we implement SB 863. And I am most appreciative of their attention to this because it's critically important that we stay on top of what's happening.

Now, there are also additional reforms that were not a part of SB 863 that for whatever series of reasons could not be effectuated. And so, I want to add that I think it's important that we do re-visit some of these additional reforms. These include addressing through legislation regulations ongoing problems with the overuse of powerful and addicting pain medications and reviewing reasons for increasing cumulative trauma claims and post-termination claims and there are others as well.

I think it would be a mistake for all of us to conclude that our work is done here. Because I think there are more cost savings that could be obtained and I hope that the legislature, and the governor, and the stakeholders will continue to look for additional opportunities in this regard. Because even if things play out as everyone hopes, we are still going to be at a place where our rates are significantly higher than many other states in the union.

Now, there are some good reason for that but there are also some frictional and transactional costs associated with that that I think we could continue to look to address. So we must be prepared to make adjustments to add to, to improve the SB 863 reforms as we learn more through the monitoring, and as we see additional opportunities.

So I really want to thank all of those who hung with us throughout the entirety of this hearing. I know there are probably many in the audience whose eyes began to roll back into the backs of their heads as we were engaged in the actuarial conversations but it's incredibly important. Perhaps no better example of the importance of math was demonstrated on November 6th where one group of people got the math right and then the other group of people seemed to be engaging in magical thinking with regard to math. And I think it's critically important we not engage in magical thinking. Regardless of where you fall in that partisan divide, it's critically important we not engage in magical thinking particularly as it relates to workers' compensation rates and the pure premium process.

So with that, my thanks. I really appreciate your attention, the thoughtfulness, your responsiveness to all the questions that we posed to you and we look forward to issuing an advisory benchmark in short order. Thank you very much.

And with that, Mr. Citko?

MR. CITKO: Yes, I just have some final housekeeping and closing items.

As we have noted here, the record will remain open but it shall close on Monday, November 19th, 2012 at 5 o'clock p.m.

I did receive today the document here from the powerpoint of the Rating Bureau and I'm going to put this in the record. We also received a disk which includes their notifications, bulletins and wire stories which we will put into the record. We will also put into the record the powerpoint from the Department which summarizes generally the figures that we received today. Uh, we have already included in the record Rating Bureau's filings up to the date and the various reference materials that they've submitted, comments of the public members and their actuary, and then the actuarial analysis of AON from October 2012 which is the bulletin that they issued. I believe that summarizes everything that we've received so far that's in the record, and again, we will receive other things until Monday at 5 o'clock, and with that, I am concluding the hearing today. Thank you.

COMMISSIONER JONES: Thank you.

(Whereupon, at 1:48 p.m. the PROCEEDINGS were adjourned.)

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REPORTER'S CERTIFICATE

I, STACI A. IWAHASHI, CSR No. 11807, Certified Shorthand Reporter, certify:

That the foregoing proceeding was duly recorded and thereafter reduced to print under my direction;

That the testimony of the witnesses, the questions propounded, and all statements made at the time were thereafter transcribed;

That the foregoing is a true and correct transcript of my shorthand notes so taken.

I further certify that I am not a relative or employee of any attorney or counsel employed by the parties hereto, nor financially interested or otherwise interested in the outcome of the action.

I declare under penalty of perjury under the laws of California that the foregoing is true and correct.

Dated this 20th day of November, 2012.

____

STACI A. IWAHASHI, CSR NO. 11807